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1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

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3 UNITED STATES OF AMERICA,

New York, N.Y.

4 v.

18 Cr. 0036(JPO)

5 DAVID MIDDENDORF and JEFFREY
6 WADA,

7 Defendants.

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9 March 4, 2019
10 9:38 a.m.

11 Before:

12 HON. J. PAUL OETKEN,

13 District Judge
14 and a jury

15 APPEARANCES

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Southern District of New York

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- also present -

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Kiezia Girard-Lawrence, Postal Inspector

Stephanie O'Connor, Defendant Middendorf paralegal

Sarah Chojecki, Defendant Wada paralegal

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(Jury not present)

THE COURT: Good morning, everyone.

ALL COUNSEL: Good morning.

THE COURT: The jury is all here notwithstanding the weather.

Anything anybody wanted to address?

MS. MERMELSTEIN: Yes, your Honor. We had filed last week a motion to preclude portions of Mr. Hanson's testimony, who is Mr. Middendorf's first witness. I think we just forgot to take it up on Thursday afternoon so I think we need to take it up before he testifies.

THE COURT: OK. Mr. Boxer, do you want to respond?

MR. BOXER: I don't think any of the portions that the government raised concern with I will be eliciting from Mr. Hanson. It is going to be his services as a PCAOB board member, some questions about the board, and then his interactions and conversations with Mr. Middendorf. I have a few documents to show him that were Outlook invitations to meetings they had, and that's really it. So, I don't expect there to be an issue.

THE COURT: OK. Anything else?

MS. MERMELSTEIN: Your Honor, one other thing that I may be misreading is going to be with Mr. Hanson, but last night or this morning Mr. Middendorf marked Defense Exhibit M300, which is an agenda for a KPMG PCAOB board meeting that

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1 Mr. Hanson attended, and it includes an attachment of
2 handwritten notes. To the extent they are intending to offer
3 that through Mr. Hanson, I think it is hearsay.

4 MR. BOXER: We are not.

5 MS. MERMELSTEIN: If not, then no need to raise it.

6 MR. BOXER: All right. It is there in case that we
7 need to refresh his recollection.

8 THE COURT: All right. Mr. Cook.

9 MR. COOK: Your Honor, there are several exhibits that
10 we admitted that had Government Exhibit stickers that we have
11 now renumbered with defense exhibit sticker numbers that we
12 want to put those in the record.

13 THE COURT: All right.

14 MR. COOK: Government Exhibit 450 has been relabeled
15 as Defense Exhibit 2450. Government Exhibit 503 has been
16 renumbered Defense Exhibit 2503. Government Exhibit 756 has
17 been renumbered Defense Exhibit 2756. Government Exhibit 800
18 has been renumbered Defense Exhibit 2800. Government Exhibit
19 930 has been renumbered as Defense Exhibit 2930.

20 THE COURT: All right. Thank you.

21 Am I right that the first witness is Mr. Hanson?

22 MR. BOXER: Yes, your Honor.

23 THE COURT: All right. And anything else before we
24 start?

25 (Pause)

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1 OK. We can bring in the jury.

2 Do you want to bring the witness in first?

3 MR. BOXER: Sure.

4 (Witness present)

5 THE COURT: Good morning. You can come on up to the
6 witness chair.

7 (Continued on next page)

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1 (Jury present)

2 THE COURT: You may be seated in the courtroom.

3 Good morning, ladies and gentlemen.

4 JURORS: Good morning, your Honor.

5 THE COURT: Welcome back. You all made it in
6 notwithstanding the weather issues. So, well done.

7 We're continuing with the testimony in the defense
8 case.

9 And, Mr. Boxer, you may call your next witness.

10 MR. BOXER: Thank you, your Honor.

11 The defense calls Jay Hanson.

12 JAY HANSON,

13 called as a witness by defendant Middendorf,
14 having been duly sworn, testified as follows:

15 THE CLERK: Please state your full name and spell your
16 last name slowly for the record.

17 THE WITNESS: Jay Hanson, H-a-n-s-o-n.

18 THE CLERK: Thank you.

19 DIRECT EXAMINATION

20 BY MR. BOXER:

21 Q. Good morning, Mr. Hanson.

22 A. Good morning.

23 Q. How old are you?

24 A. 62.

25 Q. And could you describe your educational background and

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1 experience?

2 A. I received a Bachelor of Arts degree from Concordia
3 College.

4 Q. Is that in Minnesota?

5 A. Yes.

6 Q. And could you describe for the jury your work experience
7 after graduating from Concordia College?

8 A. I started my career in public accounting with a firm that
9 was known at the time as McGladrey Hendrickson, and I worked
10 there as an employee and a partner through January of 2011.

11 Q. And could you briefly describe the positions you held in
12 McGladrey and the experience you had there?

13 A. In the early part of my career, I was an audit staff
14 member. I was later promoted to manager, later promoted to
15 senior manager, later admitted to the partnership at McGladrey,
16 all the time being an auditor. And in the middle of my career
17 I was quality control resource, involved in reviewing products
18 that the audit practice issued to clients. And the last part
19 of my career with McGladrey I was in the National Office as
20 National Director of Accounting.

21 Q. At the time you left McGladrey in January 2011, how big a
22 firm was McGladrey, approximately?

23 A. I don't -- there are many different measures. It could be
24 in terms of revenue, in terms of people --

25 Q. In terms of people.

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1 A. I believe there were over 5,000 people in the firm.

2 Q. And how did it compare, generally, to the Big Four
3 accounting firms at that time?

4 A. If my memory serves me right, it was approximately the
5 fifth largest firm in terms of total U.S. revenues.

6 Q. And in your audit experience in McGladrey, did you work on
7 audits of public companies?

8 A. Yes.

9 Q. Any particular type of public companies that you had
10 expertise in?

11 A. I had no specific expertise. It ranged in various
12 industries.

13 Q. And prior to January 2011, did you also sit on a task force
14 of the FASB?

15 A. Yes.

16 Q. That is the Financial Accounting Standards Board, correct?

17 A. Correct.

18 Q. And just briefly, what was the goal of the task force?

19 A. The task force was the Emerging Issues Task Force, which
20 was involved with providing advice to the FASB on the
21 application of accounting standards in emerging areas or areas
22 where there may have been a diversity in practice or something
23 unclear in the accounting standards.

24 Q. And in January 2011, what did you do then? What happened?
25 What was the next work you had?

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1 A. In early January 2011, I was informed by the Securities and
2 Exchange Commission that I had been appointed as a board member
3 at the PCAOB, and I started that role on February 1, 2011.

4 Q. And how long did you stay in that role for?

5 A. Approximately six years.

6 Q. Until approximately December of 2016, correct?

7 A. Yes.

8 Q. And have you been working since that time, December of
9 2016?

10 A. No, I'm retired.

11 Q. Could you describe for the jury what the PCAOB is?

12 A. The PCAOB is the regulator of auditors that audit companies
13 that trade in the United States.

14 Q. And how does it do that? How does it perform that
15 function?

16 A. It performs that function through the inspection of firms
17 that are registered with the PCAOB. It sets the audit
18 standards, so the rulebook that auditors use to conduct their
19 audits. It conducts, if necessary, enforcement investigations
20 and procedures, and it just generally oversees the conduct of
21 auditors.

22 Q. And would those enforcement proceedings be brought against
23 an audit firm or an employee or partner of an audit firm?

24 A. Yes.

25 Q. And how is the PCAOB structured?

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1 A. There are five board members and approximately 800 staff.

2 Q. And are there divisions within the PCAOB?

3 A. Yes.

4 Q. And as best you recall, what are those divisions?

5 A. The divisions include Inspections. Within Inspections is
6 Registrations, the Office of the Chief Auditor involved in
7 standard setting, the Enforcement Division. There is an
8 International Affairs office, IT function, administrative
9 function, and a research group. Those are the ones that come
10 to mind.

11 Q. OK. And you said there are five board members. How long a
12 term or period of time does each board member serve for?

13 A. A board member serves -- well, the term is specified in the
14 Sarbanes Oxley Act. It is a five-year term with the
15 possibility of a single five-year renewal.

16 Q. And when you were a board member, did you have staff that
17 was specifically assigned to you?

18 A. Yes.

19 Q. Could you describe what kind of staff that was assigned to
20 you?

21 A. I had one administrative assistant and one professional
22 assistant who was an attorney.

23 Q. And as a board member, what did you do on a daily basis?

24 What were the duties and responsibilities of a PCAOB board
25 member?

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1 A. The board approved inspection reports that were issued
2 after the completion of an inspection of a firm. The board
3 approved any remediation determinations of the firm's efforts
4 to remediate the quality control deficiencies that were
5 communicated to the firm. The board reviews and approves draft
6 audit standards and other rule-making as well as the final
7 products, if those come to a final determination. The board
8 approves the initiation of formal enforcement actions and in
9 some situations is involved after the enforcement action is
10 concluded, if there is an appeal to the board. The board
11 approves arrangements with non-U.S. regulators for the purpose
12 of conducting inspections of firms that are registered but not
13 located in the United States. The board approves the annual
14 budget for the PCAOB.

15 Q. I'm not sure if you mentioned this a moment ago, but are
16 you a CPA?

17 A. Yes.

18 Q. And does Sarbanes-Oxley have any requirement about whether
19 board members of the PCAOB should also be CPAs?

20 A. Of the five board members, to the best of my recollection,
21 the Sarbanes-Oxley Act says that two of the board members shall
22 be CPAs and the other three shall not be CPAs.

23 Q. So when you served, you were one of the two board members
24 who was a CPA?

25 A. Yes.

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1 Q. Who funds the PCAOB?

2 A. The primary funding comes from issuers, or the public
3 companies that are subject to audit by the auditors.

4 Q. And beside the issuers, are there any other sources of
5 funding that pays for the expenses and operation of the PCAOB?

6 A. Yes.

7 Q. And what would those be?

8 A. A minor portion of the budget comes from the annual fees
9 that the firms that are registered paid, and then a portion of
10 the budget comes from brokers and dealers.

11 Q. And is any of the funding -- does any of the funding come
12 from the United States? Does the government contribute to the
13 funding?

14 A. No.

15 Q. Does the SEC contribute to the funding?

16 A. No.

17 Q. So you mentioned inspection reports. Could you just
18 briefly describe what those are?

19 A. At the completion of an inspection of a registered firm,
20 there is a report prepared that has multiple parts. The unique
21 portion for a firm, generally referred to as Part I, describes
22 the number of engagements that were -- or number of issuers
23 that were selected to inspect all or a portion of the audit and
24 of those that were selected how many of those had a finding
25 that was reported with a deficiency that rose to the level of

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1 something that the board believes should be reported in the
2 report, and then for each of the anonymized issuers a brief
3 description of what the issue was.

4 Q. And the deficiency you just referenced, that's what's known
5 as a comment, correct?

6 A. Could you be a little more precise on the question?

7 Q. Sure. You mentioned deficiencies being noted in Part I of
8 the reports. My question is are those deficiencies often
9 referred to as a comment or comments?

10 A. That's not the context that comments are used in at the
11 PCAOB.

12 Q. What is your understanding of the context that comments are
13 used?

14 A. The context that I understand is a comment form, which is a
15 form that forms the basis for the discussions with a firm if
16 the inspectors that are physically doing the inspection see
17 something they believe is a deficiency, the facts that the
18 PCAOB staff understand are written into the form as well as the
19 issue that the facts present in terms of deficiency in that
20 form is provided to the firm for feedback and essentially
21 concurrence that the facts are right and then any views on the
22 issue presented.

23 Q. And if at the end of the day it's decided that the subject
24 of that comment form makes it into Part I of the report, am I
25 understanding you correct that at that point it is not called a

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1 comment any longer, as you understand it?

2 A. Yes. That is not a term that I would have used or I heard
3 used. It was more a reported failure, deficiency in the
4 report.

5 Q. Understood. And you mentioned that there was anonymity
6 with respect to the issuers I think you said, is that correct?

7 A. That is correct.

8 Q. Could you explain how that works?

9 A. Well, the deficiencies are described with a heading that
10 the very first one in a report might be issuer A and then a
11 description of what -- a brief description of the facts, which
12 just a description of the audit procedures that were not
13 performed.

14 Q. So the general public is not informed of the issuer that
15 the report speaks to its deficiencies in the audit of that
16 issuer?

17 A. That's correct.

18 MS. MERMELSTEIN: Objection to leading, your Honor.

19 THE COURT: Sustained.

20 BY MR. BOXER:

21 Q. Are you familiar with PCAOB Rule 4004 reports?

22 A. Yes.

23 Q. What do you understand those to be?

24 A. Those reports are -- it is a document that is sent from the
25 PCAOB to the SEC to describe primarily -- and I'm just

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1 reflecting on my personal experience of the majority of those
2 reports that I saw -- an accounting issue that the inspector
3 observed in an audit that was inspected where the inspector
4 didn't believe that the accounting was proper and the firm nor
5 the issuer had done anything to correct that improper
6 accounting. So, that was reported to the SEC through a Rule
7 4004 report.

8 There are other types of things that were reported on
9 a 4004 report. One that comes to mind is an independence issue
10 that the firm may not have been independent with respect to the
11 client they are auditing.

12 Q. Have you ever seen a 4004 report addressed to deficiencies
13 that were explained or described in Part I of an inspection
14 report?

15 A. Yes.

16 Q. And was that in connection with the accounting that was
17 performed at the issuer?

18 A. That would have been if there was an accounting issue that
19 was not subsequently properly addressed.

20 Q. Were you aware that the Big Four firms were recruiting from
21 the PCAOB at the time you were on the PCAOB board?

22 A. Yes.

23 Q. And did you have a view on that practice at that time?

24 MS. MERMELSTEIN: Objection.

25 MR. BOXER: I will try a few additional questions

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1 first, your Honor.

2 THE COURT: OK.

3 BY MR. BOXER:

4 Q. Did you have discussions with your other board members
5 about the Big Four firms hiring from the PCAOB?

6 A. Occasionally the topic would come up.

7 Q. And did you think it was a good thing or a bad thing that
8 that was going on?

9 MS. MERMELSTEIN: Objection.

10 THE COURT: Sustained.

11 BY MR. BOXER:

12 Q. Do you have any understanding, Mr. Hanson, as to how
13 issuers were chosen for inspection by the PCAOB?

14 A. Yes.

15 Q. And what was your understanding?

16 A. My general understanding was for the majority of the time I
17 served in the board, for the largest firms, the selection
18 process was based on a variety of risk factors.

19 Q. And what kind of risk factors were those?

20 A. What comes to mind are risk factors of something in the
21 company's financial statements didn't look correct or may have
22 been inconsistent with others in the industry. That's one type
23 of risk factor. Another risk factor might be the personnel
24 involved in conducting the audit, the partner and other
25 supporting personnel. Another factor might be if the

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1 accounting issue presented in the company's financial
2 statement, that may have initially raised a question. If the
3 firm has -- overall has had problems with that either in the
4 office that was serving the issuer or the firm overall.

5 Q. And those risk factors, have you or members of the board
6 spoken publicly about those kinds of risk factors?

7 A. I don't remember specifically, but it sounds like -- I
8 don't remember specifically but --

9 Q. Were the risk factors kept secret by the PCAOB?

10 A. The precise risk factors applying to any issuer were
11 secret, yes.

12 Q. The general risk factors that were applied by the PCAOB,
13 were those kept secret?

14 A. There were some -- no.

15 Q. And did you think it would be difficult for a Big Four firm
16 to assess what risk factors would apply?

17 MS. MERMELSTEIN: Objection.

18 THE COURT: Sustained.

19 Q. Were you aware of any of the accounting firms trying to
20 guess which of their clients' audits would be inspected?

21 MS. MERMELSTEIN: Objection.

22 THE COURT: Overruled.

23 A. I was -- at the time I was on the board, I wasn't aware of
24 any specific efforts that any firm was putting into -- into
25 trying to guess which of their clients would be inspected.

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1 Q. Were you aware of any general efforts at the time you were
2 on the board?

3 A. I was generally aware that firms were trying to look at
4 the -- across their client base at the riskiest clients that
5 they served to ensure that the standards are properly followed.

6 Q. And do you think that behavior was appropriate?

7 MS. MERMELSTEIN: Objection.

8 THE COURT: Sustained.

9 BY MR. BOXER:

10 Q. Did you ever criticize any of the accounting firms for
11 doing what you just described with respect to risk factors?

12 MS. MERMELSTEIN: Objection.

13 THE COURT: Sustained.

14 Q. Do you know Dave Middendorf?

15 A. Yes.

16 Q. Do you see him here in the courtroom today?

17 A. Yes.

18 Q. Could you point him out?

19 (The witness complied)

20 Q. And how do you know Mr. Middendorf?

21 A. I was aware that he was a member of the leadership team of
22 his firm and met him in connection with meetings that the board
23 would have with his firm.

24 Q. And would those be at PCAOB board meetings?

25 A. They would be at -- yes.

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1 Q. Were there other meetings besides PCAOB board meetings when
2 you met with Mr. Middendorf?

3 A. Yes.

4 Q. Could you generally describe those meetings?

5 A. The meetings in general were discussing how KPMG was
6 progressing on their inspections, how they're progressing on
7 their remediation of prior deficiencies, and asking questions
8 of if there is anything else I should be aware of that he
9 wanted to bring to my attention.

10 Q. And you answered those questions? You answered his
11 questions?

12 A. Well, I was as much directing questions at him, and with
13 the question he would ask me, I would give general answers to
14 the questions.

15 Q. Let's start with the board meetings.

16 How often did the board meet with -- the PCAOB board
17 meet with KPMG?

18 A. It was approximately every six months.

19 Q. And who attended those meetings?

20 A. From the PCAOB, the board members were all invited,
21 generally were present for the meetings. The senior staff of
22 the PCAOB was invited to the meetings. The general counsel's
23 office of the PCAOB was invited to the meetings, and the firm
24 itself would bring whatever number of people they felt was
25 appropriate to bring to the meetings.

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1 Q. And was the board holding similar meetings with the other
2 Big Four firms as it did with KPMG?

3 A. Yes.

4 Q. And was there -- did the meetings occur in a conference
5 room? Could you describe where the meetings took place?

6 A. In a what was referred to as the general purpose meeting
7 room of the PCAOB.

8 Q. And -- oh, by the way, do you know a person named Stephanie
9 Rodriguez?

10 A. I recognize the name. I can't place her face.

11 Q. OK. Do you know if she was at PCAOB board meetings?

12 A. I don't know.

13 Q. And with respect to KPMG, who, generally, attended those
14 board meetings from KPMG, to the best of your recollection?

15 A. To the best of my recollection, the CEO, the Vice Chair of
16 the Audit Practice, the National Managing Partner, such as
17 Mr. Middendorf's role, the partner in of the inspections, and
18 usually there was an individual that was a lawyer. I don't
19 know specifically what his role was.

20 Q. Is that Mr. Holmes, Mr. Sven Holmes?

21 A. Yes.

22 Q. And generally what topics were discussed at these board
23 meetings with KPMG?

24 A. Generally, the topics were around how the current year's
25 inspection, what was going -- whatever inspection was in

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1 process, how the firm was addressing the most significant
2 deficiencies that were recurring as reported in past inspection
3 reports. Sometimes the focus would be on what was working well
4 and why, what was not working, and what are you going to do
5 about it. Sometimes the topics would range into other oral
6 events such as some of the challenges that U.S. companies faced
7 with some of the -- the economic challenges at various European
8 countries, sometimes organizational leadership changes that the
9 firm had done or was contemplating. That's the general nature
10 of the discussions across all the firms.

11 Q. And were those meetings important to you as a PCAOB board
12 member?

13 A. Yes.

14 Q. And why were they important?

15 A. I felt that I got some information from the firm to better
16 understand what they were doing and factor that into my views
17 of their overall efforts to improve their audit quality.

18 Q. And was the firm -- was KPMG informed in advance of the
19 meeting as to what topics the PCAOB board wanted to discuss at
20 the meeting?

21 A. Yes.

22 Q. And how did that occur?

23 A. In general, they were provided a written agenda for the
24 meeting.

25 Q. And do you know how far in advance of a meeting KPMG would

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1 receive the written agenda?

2 A. My understanding is it varied from two weeks to maybe just
3 a few days.

4 Q. And did there come a time when you attended meetings with
5 Mr. Middendorf that occurred soon before the PCAOB board
6 meetings?

7 A. Yes.

8 Q. And how did that come about?

9 A. Sometime after I started with the board in 2011, I was
10 approached by a member of leadership of another firm with just
11 a request that they wondered if I would be willing to meet with
12 them before their scheduled meeting with the board to share my
13 personal views on what I thought was most important to get out
14 of the meeting. And after having several meetings like that
15 with other firms, I made it known to all the firms that I could
16 that if anybody wanted to talk with me before the meeting,
17 phone call or meeting, I would be willing to do that.

18 Q. And did you make it known to KPMG?

19 A. Yes.

20 Q. Do you recall who at KPMG you made it known to?

21 A. Yes.

22 Q. Who was that?

23 A. It would have been either Mr. Middendorf or at the time his
24 boss, the Vice Chair of Audit, Mr. Liddy, or both of them.

25 Q. And did Mr. Liddy or Mr. Middendorf accept your offer to

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1 have the meetings that you just described?

2 A. Yes.

3 Q. Did the other Big Four firms also accept your offer?

4 A. Some yes, but it was inconsistent.

5 Q. And was Mr. Middendorf present at the first I'll call it a
6 preboard meeting, if that is OK with you, was Mr. Middendorf
7 present at the first preboard meeting that you had with KPMG?

8 A. To the best of my recollection, yes.

9 Q. And was he there with Mr. Liddy as well?

10 A. Yes.

11 Q. And besides Mr. Middendorf and Mr. Liddy, who else attended
12 the first preboard meeting?

13 A. I don't recall who else attended the first one.

14 Q. Did you bring anybody with you to the first meeting, that
15 you recall?

16 A. I don't specifically recall who came with me for the first
17 meeting, but generally I brought another one of my fellow board
18 members with me to a meeting.

19 Q. And why was that?

20 A. I understood the general guidance provided to board members
21 was that for meetings of any kind with firm leadership, that it
22 was advisable to have another board member or staff
23 representative of the PCAOB accompany the board member.

24 Q. So you observed that rule?

25 A. Yes.

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1 Q. And did your -- did anybody from your staff attend any of
2 the preboard meetings with Mr. Middendorf?

3 A. Yes.

4 Could I go back?

5 Q. You want to correct an answer?

6 A. Yes. What I just said, it was not an unqualified yes to
7 that prior question about did somebody accompany me. I made
8 every effort to have somebody with me. There may have been an
9 occasion or two where the circumstances were such that I ended
10 up meeting by myself.

11 Q. Understood. And was there a particular board member who
12 would accompany you to these preboard meetings with
13 Mr. Middendorf when you brought somebody with you?

14 A. Yes. I believe I said my fellow board member, Jeanette
15 Franzel.

16 THE COURT: Jeanette Franzel?

17 THE WITNESS: Yes.

18 THE COURT: Is that F-r-a-n-z-e-l-l?

19 THE WITNESS: A single L.

20 THE COURT: OK. Thanks.

21 BY MR. BOXER:

22 Q. And at these preboard meetings, did anyone from your staff
23 also attend?

24 A. I don't specifically recall for the premeetings, especially
25 with KPMG, if any of my staff came with me.

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1 Q. Did you inform your staff that you were having the preboard
2 meetings with Mr. Middendorf?

3 A. Yes.

4 Q. Did you inform your fellow board members that you were
5 having the preboard meeting -- preboard meetings with
6 Mr. Middendorf? Did you let the other board members know about
7 that?

8 A. Generally other than Ms. Franzel, I did not make it a habit
9 of telling my fellow board members about the meetings.

10 Q. And specifically to Mr. Middendorf, what do you recall
11 being discussed at the preboard meetings that Mr. Middendorf
12 attended with you?

13 A. I don't have any recollection of any specific discussions,
14 but the general discussion would have been my views of the
15 topics presented to them in the agenda and my questions that I
16 had that may have been in more depth than I would have asked
17 with the full board just as a practical -- not enough time in a
18 full board meeting to get all the questions that I had, and the
19 ability to have a conversation and question him on things in
20 the agenda that the board was interested in that I was
21 particularly interested in that would help inform me personally
22 as to what questions I may raise with the full board in the
23 meeting.

24 Q. And was the purpose of these preboard meetings to help KPMG
25 prepare for the board meetings?

J34dmid1

Hanson - direct

1 A. I believe that they understood or that they -- well, I
2 viewed it as a way to share my personal views of what I felt
3 was most important to me on the agenda.

4 Q. And did you believe that that would help KPMG be better
5 prepared at the actual board meeting?

6 A. Yes.

7 Q. Did you review the agenda with Mr. Middendorf at these
8 preboard meetings?

9 A. Generally, yes.

10 Q. And were there instances when the agenda had not yet been
11 released to KPMG at the time of these preboard meetings?

12 A. Yes.

13 Q. And were there instances where you handed a draft agenda to
14 Mr. Middendorf for his review at these preboard meetings?

15 MS. MERMELSTEIN: Objection to all the leading, your
16 Honor.

17 THE COURT: Sustained, but just with a warning. This
18 one is fine.

19 MR. BOXER: Understood.

20 BY MR. BOXER:

21 Q. Do you recall whether or not you ever provided any
22 materials to Mr. Middendorf during these preboard meetings?

23 A. I don't recall specifically. I do recall a meeting where,
24 to my surprise, the agenda had not been provided to the firm
25 yet and I used my personal copy of the draft agenda with my

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1 views of what the agenda should be, which in the normal process
2 of creating the agenda, board members would provide their views
3 as to what should be on the agenda. And it might be wording,
4 it might be ordering, it might be additional topics to add, it
5 might be questions about why topics are on there. So I recall
6 that I had my version of the draft that I had hoped would be
7 the agenda, not knowing what the final agenda would be, and I
8 would have discussed what I viewed to be the agenda not knowing
9 if it was going to be the final agenda.

10 Q. And did you give that agenda that you just described that
11 had your personal views did you give that to Mr. Middendorf to
12 keep at the meeting?

13 A. I don't recall if I gave it to him or not.

14 Q. Do you recall approximately when this meeting that you just
15 described took place?

16 A. No.

17 MR. BOXER: If we can show the witness Exhibit M13,
18 not yet in evidence, please.

19 (Pause)

20 Q. I just ask you to take a look at that, Mr. Hanson, and tell
21 me if you recognize it.

22 A. I don't specifically recall this exact document, but it
23 appears to be a calendar invite for --

24 Q. From you?

25 A. From me. That's what it shows.

J34dmid1

Hanson - direct

1 Q. You can't describe it until it is evidence. You shouldn't
2 be describing it too much.

3 MR. BOXER: I offer it, your Honor, M13.

4 THE COURT: M13, any objection?

5 MS. MERMELSTEIN: No, your Honor.

6 THE COURT: M13 is received.

7 (Defendant's Exhibit M13 received in evidence)

8 BY MR. BOXER:

9 Q. I apologize for interrupting, but now, Mr. Hanson, if you
10 could just describe what M13 is?

11 A. The document in front of me shows "Appointment" across the
12 top, which to me suggests it was something from an Outlook
13 calendar invite, that shows it is sent from me to myself,
14 Jeanette Franzel, Nancy George, who I don't know but I assume
15 was an administrative person at KPMG, and Jim Liddy to set the
16 date and time for a meeting with what appears to be a lunch
17 meeting.

18 Q. With you and Ms. Franzel, a fellow board member?

19 A. Yes.

20 Q. And the lunch meeting is at a hotel in Washington, D.C.,
21 correct?

22 A. Yes. And I can see the subject says "Lunch meeting." What
23 I don't understand is the start time shows 5:30 p.m. That
24 doesn't make any sense to me.

25 Q. It doesn't. And I could just represent that the times in

J34dmid1

Hanson - direct

1 some instances is it fair to say are Greenwich Mean Time, is
2 that --

3 MS. MERMELSTEIN: I'm not sure counsel should be
4 representing anything.

5 MR. BOXER: Withdrawn.

6 MS. MERMELSTEIN: It is fine.

7 BY MR. BOXER:

8 Q. Leaving aside the time -- withdrawn.

9 Do you know where Mr. Middendorf worked, where his
10 office was

11 A. I understood it to be New York City.

12 Q. OK. If we could show now show you what's been marked as
13 Exhibit M1.

14 Do you recognize that document?

15 A. I don't recognize the specific document, the --

16 Q. That's fine.

17 MR. BOXER: I offer it, your Honor.

18 MS. MERMELSTEIN: Your Honor, the witness is not on
19 this document, and I don't think a foundation has been laid.

20 MR. BOXER: His name is on it.

21 MS. MERMELSTEIN: He is not a sender or a recipient,
22 and he said he didn't recognize it.

23 THE COURT: Sustained.

24 BY MR. BOXER:

25 Q. Do you recall whether or not you had another preboard

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Hanson - direct

1 meeting with Mr. Middendorf on April 22, 2015?

2 A. I don't recall a specific date for a meeting.

3 Q. If I could show you again M1 and ask you to look at that
4 and just tell me if that refreshes your recollection as to
5 whether or not you had a meeting -- well, I'll wait until you
6 are done reading it.

7 A. The subject line --

8 Q. Please don't read from it.

9 Have you looked at it?

10 A. I have looked at it.

11 Q. OK. We can take it off the screen.

12 Does that refresh your recollection that a preboard
13 meeting occurred between you and Ms. Franzel and Mr. Middendorf
14 on April 22, 2015? Does it refresh your recollection?

15 A. It refreshes my recollection that the location specified in
16 the email was a location that I remember having a meeting at.
17 I don't remember the date.

18 Q. And what was that location?

19 A. Reagan Airport.

20 Q. And where -- do you recall who was at this meeting at
21 Reagan Airport besides you and Mr. Middendorf?

22 A. Yes.

23 Q. Who else was present?

24 A. Mr. Liddy.

25 Q. And was anybody -- was another PCAOB board member with you

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Hanson - direct

1 as well?

2 A. If my memory serves me correct, Ms. Franzel was intending
3 to be at the meeting with me and got held up in another meeting
4 so I was by myself.

5 Q. And where in Reagan Airport do you recall the meeting took
6 place?

7 A. At a restaurant.

8 Q. And why did it occur at Reagan Airport, do you recall?

9 A. I don't recall the specifics other than timing was -- the
10 timing and logistics for setting these meetings were often a
11 challenge, and I don't recall if I had -- well, I recall that
12 they flew in to meet with me. I don't recall my personal
13 circumstance as to why we chose Reagan.

14 Q. And do you recall anything about the substance of the
15 meeting?

16 A. I recall that that was the meeting that I was surprised
17 that they didn't have the agenda with them, so that I just
18 shared my personal views of what was my personal draft, not
19 knowing that that was going to be the final agenda.

20 Q. And do you recall what those personal views or topics were
21 that were discussed at that meeting?

22 A. Not specifically.

23 Q. And do you recall attending a preboard meeting on
24 February 4, 2016, with Mr. Middendorf?

25 A. I don't recall a specific meeting on that date.

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Hanson - direct

1 Q. I am going to show you what's marked as M73 and again ask
2 you to just look at it to see if it refreshes your
3 recollection, and then look up and I will ask you the question
4 again.

5 (Pause)

6 A. I can see the information but I --

7 Q. Sorry to interrupt you again.

8 A. I don't specifically recall that meeting.

9 Q. OK. Do you recall at one of your meetings -- you can take
10 it down.

11 Do you recall that one of your meetings with
12 Mr. Middendorf occurred at the Capital Hill Hilton in
13 Washington, D.C.?

14 A. Could you be a little more precise on that, that
15 description of the hotel?

16 Q. It's the Capital Hill Hilton, the Northgate Grill
17 Restaurant. Do you recall a meeting taking place there?

18 A. I don't believe there is a hotel called -- I am not aware
19 of a hotel called the Capital Hill. I understand there is a
20 Capital Hilton, but I don't specifically recall a meeting
21 there.

22 Q. At the Capital Hilton?

23 A. No.

24 Q. And did there come a time when instead of Mr. Liddy someone
25 else attended these preboard meeting with you and

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Hanson - direct

1 Mr. Middendorf?

2 A. Yes.

3 Q. And who was that?

4 A. Mr. Scott Marcello was the one after Mr. Liddy -- after
5 Mr. Liddy's position was replaced by Mr. Marcello, he started
6 attending the meetings.

7 Q. And do you recall that in one instance, instead of a
8 meeting, you had a phone call with Mr. Middendorf before the
9 board meeting?

10 MS. MERMELSTEIN: Objection to leading, your Honor.

11 THE COURT: Overruled.

12 A. I don't specifically recall a phone call.

13 MR. BOXER: OK. If I could show the witness what's
14 marked as Exhibit M130.

15 And if you could -- if we could scroll down to the
16 bottom.

17 And then scroll up to the top.

18 (Pause)

19 Q. Do you recognize this document?

20 A. I don't specifically recall or recognize it, but it appears
21 to be interaction back and forth about setting up a meeting.

22 Q. Emails between you and Mr. Middendorf?

23 A. Yes.

24 MR. BOXER: I offer it, your Honor.

25 MS. MERMELSTEIN: Objection to the hearsay, your

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Hanson - direct

1 Honor.

2 MR. BOXER: It is not offered for the truth, your
3 Honor.

4 THE COURT: Overruled. M130 is received.

5 (Defendant Middendorf Exhibit M130 received in
6 evidence)

7 MR. BOXER: If we could go to the bottom email,
8 please.

9 Q. And if you could read the last two sentences of that email
10 from Mr. Middendorf to you on September 6, 2016, please?

11 If you could read that out loud.

12 A. "I wanted to reach out and see if you, and Jeanette, would
13 have some time to meet with Scott Marcello and myself before
14 our meeting with the Board to help us prepare and get some idea
15 of what may be on the agenda. Could you provide some dates and
16 time you would be available to meet with us?"

17 Q. Then if we go up to the bottom of the first page, if you
18 could read the second paragraph of your response to
19 Mr. Middendorf?

20 A. "We have not had our internal prep meeting yet, and I can't
21 find that it has been scheduled. However, let's get something
22 on the calendar to talk. Here are some dates that would work
23 for a meeting or call."

24 Q. So is it fair to say that -- withdrawn.

25 What did you mean by when you said "we have not had

J34dmid1

Hanson - direct

1 our internal prep meeting yet"?

2 A. Before an agenda would be presented to the firm for
3 purposes of preparing for the meeting with the board, there
4 would be an internal prep meeting involving the PCAOB board and
5 relevant staff from the Inspections Division to share with the
6 board an overview of how the current year's inspection was
7 going, any relevant things that the staff thought was
8 appropriate to bring to the attention of the board. At the
9 board prep meetings, there was typically a draft agenda
10 presented to the board for feedback. Some but not all board
11 members were usually present at those meetings. And at the
12 conclusion of those meetings, the staff took whatever input
13 they received from the board, whether it be oral or a written
14 input, and from that point made decisions. And I personally
15 don't know how the decisions are made or what exactly would be
16 on the agenda, but at some point subsequent to that, the
17 internal prep meeting involving the board, the agenda would be
18 transmitted to the firm.

19 Q. And looking at M130, are you indicating to Mr. Middendorf
20 that you wanted to meet with him after that internal prep
21 meeting took place?

22 MS. MERMELSTEIN: Objection to leading.

23 THE COURT: Overruled.

24 A. My general practice was meeting with the firm when they had
25 the agenda in their hands, and sometimes just for pure

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Hanson - direct

1 logistics to get something on the calendar, as I suggested
2 here, I wanted to get something on the calendar expecting that
3 by the time I came, the firm would have the agenda from the
4 board -- or from the staff, as it transmitted it, as a basis
5 for the discussion.

6 Q. I would like to show you now what's marked as M129.

7 And do you recognize that document, just generally?

8 A. Generally, this looks like a calendar --

9 MR. BOXER: I offer it, your Honor.

10 MS. MERMELSTEIN: No objection.

11 THE COURT: 129 is received.

12 (Defendant's Middendorf Exhibit M129 received in
13 evidence)

14 MR. BOXER: If we can display it to the jury.

15 BY MR. BOXER:

16 Q. What is the subject of M129?

17 A. "Discuss meeting with PCAOB board on September 29th."

18 Q. And the date for the phone call is September 26th?

19 A. Correct.

20 Q. Is this an invitation for a phone call for a preboard
21 meeting of the kind you have been describing this morning?

22 A. Yes.

23 Q. OK. During these preboard meetings with Mr. Middendorf,
24 did you ever discuss with him your understanding of what the
25 mission of the PCAOB is?

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Hanson - direct

1 A. I don't recall ever discussing that, no.

2 Q. Did you ever discuss with him audit quality at any of those
3 meetings?

4 A. Yes.

5 Q. And what do you recall about those discussions?

6 A. I don't recall specifics, but the general discussions would
7 have been around the things that KPMG was doing to improve
8 audit quality in the areas where there were deficiencies
9 identified.

10 Q. Did you ever discuss with Mr. Middendorf your view on
11 things the PCAOB was doing or not doing to improve audit
12 quality?

13 MS. MERMELSTEIN: Objection to leading and relevance.

14 MR. BOXER: It goes to his state of mind, your Honor.

15 MS. MERMELSTEIN: Your Honor, I think this was
16 submitted specifically in the letter.

17 THE COURT: Overruled.

18 You can answer it.

19 THE WITNESS: I'm sorry, could you repeat the
20 question?

21 MR. BOXER: Sure.

22 BY MR. BOXER:

23 Q. Did you ever discuss with Mr. Middendorf your view on
24 things that the PCAOB was doing or not doing to improve audit
25 quality?

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Hanson - direct

1 A. I don't specifically recall any discussions like that.

2 Q. Do you recall any general discussions on that topic?

3 A. Well, I recall general discussions that I have had with
4 many people about my views of what the PCAOB should be -- could
5 be doing to improve audit quality, but I don't recall
6 specifically any discussions with KPMG on that topic or Dave
7 Middendorf.

8 Q. And what general discussions on that topic do you recall?

9 MS. MERMELSTEIN: Objection, your Honor.

10 MR. BOXER: Let me try it this way.

11 Q. Were those -- you said you had discussions about your views
12 of what the PCAOB should be doing with many people, correct?

13 A. Correct.

14 Q. Were those public discussions that you were just referring
15 to?

16 A. I don't specifically recall those, but in my role as a
17 board member, I gave many speeches, met with many groups
18 outside the PCAOB, and I recall that I routinely would have
19 shared my views on things that I thought the PCAOB could do
20 towards improving -- helping all registered firms improve audit
21 quality.

22 Q. And what were those things that you shared routinely as to
23 what all firms could be doing to improve audit quality?

24 MS. MERMELSTEIN: Objection, your Honor.

25 THE COURT: Sustained.

J34dmid1

Hanson - direct

1 BY MR. BOXER:

2 Q. Did you -- do you recall discussions with Mr. Middendorf at
3 these preboard meetings about PCAOB inspections?

4 A. Yes.

5 Q. And what do you recall about what you said at preboard
6 meetings about PCAOB inspections?

7 A. I don't recall any specific things that I would have said,
8 but generally I was interested in hearing Mr. Middendorf's
9 views as to the progress in the current inspection progress
10 overall in addressing inspection deficiencies.

11 Q. Did you have any discussions at these preboard meetings
12 with Mr. Middendorf about PCAOB inspectors?

13 MS. MERMELSTEIN: Objection, your Honor.

14 THE COURT: Overruled.

15 THE WITNESS: Could you repeat the question?

16 BY MR. BOXER:

17 Q. Did you have any discussions at these preboard meetings
18 with Mr. Middendorf about PCAOB inspectors?

19 A. I recall some -- yes, I recall some discussions.

20 Q. You do or you don't? I'm sorry.

21 A. Yes.

22 Q. And could you describe those discussions --

23 MS. MERMELSTEIN: Objection.

24 Q. -- to Mr. Middendorf, what you said to Mr. Middendorf?

25 MS. MERMELSTEIN: Objection to hearsay, relevance, and

J34dmid1

Hanson - direct

1 I think this has been briefed and your Honor ruled on this this
2 morning.

3 MR. BOXER: I'm not sure what ruling we are referring
4 to, but I think it is not being offered for the truth, it's a
5 board member speaking to Mr. Middendorf.

6 THE COURT: Overruled.

7 You can answer.

8 MR. BOXER: Should I repeat it?

9 THE WITNESS: Yes.

10 MR. BOXER: OK.

11 BY MR. BOXER:

12 Q. Could you describe discussions that you had with
13 Mr. Middendorf about PCAOB inspectors?

14 A. I don't remember specific discussions, but the discussions
15 sometimes I recall were Mr. Middendorf just --

16 MS. MERMELSTEIN: Objection, your Honor, to what
17 Mr. Middendorf said.

18 THE COURT: Sustained.

19 Q. If you could describe what you recall generally you said on
20 that topic to Mr. Middendorf?

21 A. The only thing I recall with any specificity is at the time
22 KPMG hired a particular senior person from the PCAOB that I had
23 personally interacted with many times in my role as a board
24 member, and I thought this particular person was a very solid,
25 sound, quality individual and I thought it was a good addition

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Hanson - direct

1 to his firm.

2 Q. Do you recall the name of that individual?

3 A. Yes.

4 Q. And what was his name?

5 A. Her name was Louann.

6 Q. I apologize. What was her name?

7 A. Louann Sakala.

8 Q. Sakala?

9 A. Sakala. I don't know the spelling of that.

10 Q. Did you at these preboard meetings have any discussions
11 with Mr. Middendorf about KPMG's performance on the inspection
12 reports?

13 A. Yes.

14 Q. And what do you recall about those discussions?

15 A. My general recollection was the -- KPMG's focus on reducing
16 the number of inspection findings and improving audit quality
17 and the things that they were doing to improve audit quality.

18 Q. And do you recall any discussion with Mr. Middendorf where
19 those two concepts, audit quality and improving inspection
20 performance, you had discussions with him about those two
21 concepts together?

22 A. Yes.

23 Q. And what do you recall about that?

24 A. I recall a general discussion about the efforts of KPMG to
25 reduce inspection findings should be holistic in terms of

J34dmid1

Hanson - direct

1 improving audit quality which would then result in fewer
2 inspection findings.

3 Q. What do you mean by "holistic"?

4 A. Focused on all clients in ensuring the compliance with the
5 PCAOB standards, which would then result in fewer inspection
6 findings.

7 Q. And did you have any discussion at that time with
8 Mr. Middendorf about whether or not the PCAOB inspectors were
9 acting in a holistic way?

10 MS. MERMELSTEIN: Objection.

11 THE COURT: Overruled.

12 A. I don't recall a conversation like that.

13 Q. If I could show you what's marked as JH1, and ask you -- do
14 you have it?

15 MR. BOXER: May I approach, your Honor?

16 THE COURT: Yes.

17 (Pause)

18 Q. If you can look at what's marked as JH1, the sixth
19 paragraph, and I ask you if you could read that, and then when
20 you are done reading it, put it down.

21 A. So you're asking me just to read --

22 Q. Just to read it. Then I am going to ask --

23 THE COURT: To yourself.

24 MR. BOXER: To yourself.

25 Thank you, your Honor.

J34dmid1

Hanson - direct

1 MS. MERMELSTEIN: Your Honor, I apologize. May we
2 approach?

3 THE COURT: Yes.

4 (Continued on next page)

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J34dmid1

Hanson - direct

1 (At the sidebar)

2 MS. MERMELSTEIN: Mr. Boxer is now treading broadly
3 into the topics that we moved to preclude and which he said he
4 would not go into. He has just attempted to refresh
5 Mr. Hanson's recollection that Mr. Hanson had previously said
6 that there was an attitude at the PCAOB about "gotcha"
7 mentality where they were sort of looking for problems. Much
8 of that it is clear is in fact based on hearsay, although the
9 question does not say did someone tell you, because this is a
10 witness who was never an inspector, he was never a member of an
11 inspection team. His only information about sort of what
12 people were doing on the ground is hearsay.

13 Separately, it is completely irrelevant. The notion
14 that somehow some PCAOB inspectors were harsh or that there was
15 an attitude of looking for problems is irrelevant. The
16 question here is not whether or not the PCAOB was overly harsh
17 as a regulator, and it's irrelevant and prejudicial. So,
18 nothing about this should be asked.

19 MR. BOXER: A few things, your Honor.

20 First, this is a PCAOB board member speaking with our
21 client, so the state of mind as far as Mr. Middendorf is very
22 relevant. And I think the relevance is that -- I'm not sure he
23 is going to remember this, but the relevance is that when it
24 comes to 2016 and he authorizes a review of the workpapers, he
25 does that because he thinks -- he intends for them to get a

J34dmid1

Hanson - direct

1 fair shake on the inspection knowing that -- from the board
2 member, that inspectors are out there to find problems. And it
3 is an unfairness and that's why he does it, for better or
4 worse.

5 As far as him never being an inspector, I think all of
6 that goes to the weight of the evidence. But he is sitting
7 down at this somewhat secret meeting with a member of the
8 board, and the board member is saying instead of worrying about
9 holistic audit quality, he's concerned that the inspectors are
10 just trying to play gotcha and find comments. So my client has
11 that in his mind when this list comes in 2016, and he says,
12 yeah, go ahead, do the rereview, look at the workpapers, make
13 sure they are as clear as they could be so that they can't play
14 a game of gotcha. That is the relevance of it.

15 I don't know if he is going remember it or not. It is
16 actually my last question so I don't have any further place to
17 go on this.

18 MS. MERMELSTEIN: That just makes clear the problem,
19 your Honor. If Mr. Middendorf's defense is that it was OK to
20 cheat because the test was unfair, then that is not a
21 legitimate defense and the question is not proper. And I also
22 think it is hugely problematic to put to this witness this
23 general what did you discuss, because what Mr. Middendorf said
24 is hearsay. And if he wants to put in what he said, then he
25 should testify, as he may do.

J34dmid1

Hanson - direct

1 What Mr. Hanson said may or may not be relevant to
2 state of mind. It is clearly not in this case. But it can't
3 be lumped together in that fashion to avoid the hearsay issue

4 MR. BOXER: I just want to correct something counsel
5 said. The defense is not that it was OK to cheat. He didn't
6 view it as cheating because AS 3 was complied with and they
7 were in the documentation period. Why he allowed it, why he
8 permitted it was informed by what he heard from the board
9 member.

10 THE COURT: I think this is tricky because I think it
11 could be relevant to state of mind in terms of the overall
12 background. It is a communication from a PCAOB board member,
13 which I think is significant. I think it is tricky to go too
14 much into this because it could get into cross-examination on
15 the terms of this witness' separation from the PCAOB, which I
16 precluded testimony that I think goes to opinion that could
17 improperly elicit bias and motive, but this is getting closer.

18 If you think this is the last question on this, I'm
19 going to allow you to refresh and see where that goes.

20 MR. BOXER: It will be the last question, your Honor,
21 and it is actually the last question of the examination.

22 MS. MERMELSTEIN: Your Honor, I think, two things. I
23 think one is it is important that that question make clear what
24 Mr. Middendorf said versus what Mr. Hanson said. I think those
25 things are very different. And I think the letter your Honor

J34dmid1

Hanson - direct

1 may refer to is still ex parte and under seal with respect to
2 the bias issue.

3 THE COURT: I received two ex parte letters.

4 MR. BOXER: I was going to say --

5 MS. MERMELSTEIN: But we have not -- we may or may not
6 want to be heard depending on where this goes.

7 MR. BOXER: For the record, this is the first I'm
8 hearing of the ex parte letters, and I am actually unaware of
9 any topic that would be ex parte with regard to this witness.
10 So whatever was written about it, I'm sure I am not going
11 there?

12 MS. MERMELSTEIN: I don't think you are going there.
13 We may want to go there.

14 (Continued on next page)
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J345mid2

Hanson - cross

1 (In open court)

2 BY MR. BOXER:

3 Q. Mr. Hanson, having looked at Exhibit JH-1, does that
4 refresh your recollection about any statements you made to
5 Mr. Middendorf during these pre-board meetings about improving
6 audit quality and the actions of the inspectors at the PCAOB?

7 A. I don't recall specific discussions like that with
8 Mr. Middendorf.

9 Q. Do you recall any general discussions?

10 A. No.

11 Q. I will take the exhibit back.

12 MR. BOXER: I have nothing further, your Honor.

13 THE COURT: Thank you.

14 Ms. Mermelstein?

15 MS. MERMELSTEIN: Thank you, your Honor.

16 CROSS EXAMINATION

17 BY MS. MERMELSTEIN:

18 Q. Good morning, Mr. Hanson.

19 A. Good morning.

20 Q. You mentioned in your direct testimony on a number of
21 occasions the Big Four, that is, Ernst & Young, KPMG, Deloitte
22 and PwC; is that right?

23 A. That's correct.

24 Q. Those are the largest four accounting firms in the United
25 States?

J345mid2

Hanson - cross

1 A. That's correct.

2 Q. And they're sort of in their own category, that's why they
3 get talked about as the Big Four all the time?

4 A. That's correct.

5 Q. The PCAOB regulates auditors, right?

6 A. Correct.

7 Q. The SEC also regulates auditors, right?

8 A. That is my understanding.

9 Q. For example, the SEC sets auditor independence rules?

10 A. That's my understanding.

11 Q. They bring enforcement actions directly against auditors?

12 A. Yes.

13 Q. Which the PCAOB does as well?

14 A. Yes.

15 Q. And the SEC oversees the PCAOB, right?

16 A. That's correct.

17 Q. So, for example, it approves the budget?

18 A. Yes.

19 Q. It appoints board members like you?

20 A. Yes.

21 Q. And, as a PCAOB board member, you interacted somewhat
22 frequently with the SEC, right?

23 A. Yes.

24 Q. You provided the SEC with updates on what the PCAOB was
25 seeing in inspections?

J345mid2

Hanson - cross

1 A. Yes.

2 Q. And then the SEC and the PCAOB considered, among other
3 things, the inspection findings in considering how to set or
4 change audit standards or whether or not audit standards should
5 be changed?

6 MR. WEDDLE: Objection to the form of the question.

7 THE COURT: I'm sorry?

8 MR. WEDDLE: Objection to the form.

9 THE COURT: If you could please rephrase.

10 BY MS. MERMELSTEIN:

11 Q. Sure. One of the things -- withdrawn.

12 The SEC and PCAOB consulted about the setting of new
13 audit standards; is that right?

14 A. Broadly using the word consulting, yes.

15 Q. And one of the things that was considered in whether or not
16 a new audit standard should be implemented or whether or not
17 the existing standard was appropriate was inspection findings
18 with respect to that audit standard, right?

19 A. Yes.

20 MR. WEDDLE: Object to the form.

21 THE COURT: Overruled.

22 BY MS. MERMELSTEIN:

23 Q. The SEC also received the PCAOB inspection reports, right?

24 A. Correct.

25 Q. They received both the public and the non-public version,

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Hanson - cross

1 right?

2 A. That is my understanding.

3 Q. And they received the identity of the issuers that were
4 anonymized for the public?

5 A. That's correct.

6 Q. In some instances the SEC followed up with the PCAOB about
7 the content of inspection reports, right?

8 MR. BOXER: Objection.

9 THE COURT: Overruled.

10 THE WITNESS: That is my understanding.

11 BY MS. MERMELSTEIN:

12 Q. So, for example, representatives from the SEC's Office of
13 the Chief Accountant came to the PCAOB physically to review
14 comment forms and the other underlying documentation that
15 contained much more detail about inspection results than the
16 inspection report itself?

17 MR. BOXER: Objection. Compound.

18 THE COURT: If you understand the question you can
19 answer.

20 THE WITNESS: I understand the question and that's my
21 understanding.

22 BY MS. MERMELSTEIN:

23 Q. Now the principal way by which PCAOB regulates auditors is
24 through the inspection process, right?

25 Are you struggling with principal?

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Hanson - cross

1 MR. BOXER: Objection, your Honor. He is trying to
2 answer.

3 THE COURT: Sustained.

4 BY MS. MERMELSTEIN:

5 Q. The vast majority of the PCAOB's personnel work on
6 inspections, right?

7 A. I'm not sure if I understand the full characterization of
8 vast majority. I can tell you the numbers as I recall them.

9 Q. How many people on PCAOB work on inspections as inspectors?

10 A. The inspectors division includes approximately 500 people.

11 Q. So, more than half of the total personnel of the PCAOB?

12 A. That's correct.

13 Q. And, the PCAOB doesn't notify a firm of a particular
14 inspection until shortly before that inspection is going to
15 take place, right?

16 A. That's my understanding.

17 Q. And after the expiration of the 45-day documentation
18 period, right?

19 A. That's my understanding.

20 Q. The documentation period is, to put it colloquially, an
21 opportunity for the firm to put a bow on its work, right?

22 MR. BOXER: Objection.

23 THE COURT: Sustained.

24 BY MS. MERMELSTEIN:

25 Q. Have you previously described the documentation period as

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Hanson - cross

1 an opportunity for a firm to put a bow on its work?

2 A. Yes.

3 Q. And the purpose of that is not for the firm to be doing new
4 audit work, right? That's prohibited?

5 A. That's correct.

6 Q. And it is not for extensive documentation to be done?

7 MR. BOXER: Objection.

8 THE COURT: Overruled.

9 BY MS. MERMELSTEIN:

10 Q. If you can answer the question and then I will let you
11 clarify. The purpose is not for extensive documentation to be
12 done during the 45 days, right?

13 MR. BOXER: Objection.

14 THE COURT: Overruled.

15 You can testify to your understanding.

16 THE WITNESS: I understand the purpose is not to do
17 extensive documentation in that 45-day period.

18 Q. To go back, with respect to doing new audit work in the 45
19 days, that is generally prohibited, right?

20 MR. BOXER: Objection.

21 THE COURT: Overruled.

22 THE WITNESS: When you say "generally," there is a
23 provision that if additional audit work is done then certain
24 protocols must be followed.

25 BY MS. MERMELSTEIN:

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Hanson - cross

1 Q. You have gotten ahead of me.

2 So, if new audit work has to be done, that has to be
3 carefully documented, right?

4 A. That's correct.

5 Q. There has to be a record that new audit work was performed
6 after the expiration of the 45 days, right?

7 A. That's correct.

8 Q. Now, the reason that the PCAOB doesn't notify a firm that
9 an inspection is going to occur until after the 45 days have
10 expired is because it wants to see exactly what work the firm
11 had done prior to the notice being received, right?

12 MR. BOXER: Objection.

13 THE COURT: Overruled.

14 THE WITNESS: That's my general understanding.

15 BY MS. MERMELSTEIN:

16 Q. And it wants to see what the quality of the documentation
17 was prior to the notice being received, right?

18 A. That's my understanding.

19 Q. And quality of the documentation work can affect whether or
20 not a comment is written, right?

21 A. I personally struggle to answer precisely that question
22 because I understand -- my personal view is the quality of the
23 documentation could affect the, whether an issue is raised or
24 comment is written but I was personally never an inspector, I
25 never sat in the chair of making that decision.

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Hanson - cross

1 Q. So, that's just your view?

2 A. Yes.

3 Q. As a board member of the PCAOB you're familiar with the
4 PCAOB ethics code; is that right?

5 A. Yes.

6 Q. In fact, you had to certify your compliance with the ethics
7 code each year?

8 A. Yes.

9 Q. And, in particular, you are familiar with EC 9?

10 A. Yes.

11 Q. That governs confidentiality of the PCAOB information?

12 A. Yes.

13 Q. You are also familiar with the Sarbanes-Oxley Act, right?

14 A. Generally familiar. I don't know the specific words in it
15 anymore.

16 Q. Fair enough.

17 The focus area for a particular inspection is
18 confidential PCAOB information, right?

19 MR. WEDDLE: Objection, your Honor.

20 THE COURT: Overruled.

21 THE WITNESS: That is my understanding.

22 BY MS. MERMELSTEIN:

23 Q. Now, sometimes the PCAOB would publicly announce a
24 particular area that was going to be something the PCAOB looked
25 at in a particular year. It might say we are interested in

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Hanson - cross

1 this particular audit standard, for example; right?

2 A. That is correct.

3 Q. That is not the same thing as giving advance notice of what
4 the focus areas would be for particular inspections, right?

5 MR. BOXER: Objection.

6 THE COURT: Overruled.

7 A. That's correct.

8 Q. Now, you testified about some meetings with Mr. Middendorf
9 and Mr. Marcello or Mr. Liddy in advance of the PCAOB-KPMG
10 board meetings and, just so it is clear, in general, you
11 scheduled those meetings intentionally to occur only after the
12 firm had received the agenda for the meeting; is that right?

13 MR. BOXER: Objection.

14 THE COURT: Overruled.

15 THE WITNESS: That was my goal, yes.

16 BY MS. MERMELSTEIN:

17 Q. And I think you testified that there was one instance in
18 which you assumed the firm had received the agenda and then
19 discovered, upon arriving at the meeting, that they had not?

20 A. That's correct.

21 Q. And when you engaged in discussions during that particular
22 meeting, did you limit yourself to topics that you understood
23 the firm had already been made aware of?

24 A. Yes.

25 Q. You attended meetings with Mr. Middendorf on multiple

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Hanson - cross

1 occasions in 2016; is that right?

2 A. Could you be more precise on multiple?

3 Q. At least two, fair to say?

4 A. That's my recollection but I don't -- I can't say that for
5 certain.

6 Q. Did he ever tell you that he had received advance notice of
7 an inspection list for financial engagements that were going to
8 be inspected for KPMG?

9 A. No.

10 Q. Did he ever tell you that KPMG was going to conduct
11 re-reviews for inspections that it learned were on the PCAOB's
12 list of engagements be to be inspected?

13 A. No.

14 Q. Are PCAOB inspection lists confidential?

15 A. Could you be more precise with inspection list, how you are
16 referring to?

17 Q. PCAOB's inspection selections for a firm are highly
18 confidential until they are formally provided to the firm,
19 right?

20 MR. BOXER: Objection.

21 THE COURT: Overruled.

22 A. They are highly confidential always and I understand the
23 firm understands that when they are notified about individual
24 engagement to be inspected, that they know at that time what
25 the individual issuer is.

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Hanson - cross

1 Q. In other words, it is confidential from the rest of the
2 world even after the firm has been noticed?

3 A. Yes.

4 Q. But it is confidential with respect to the firm until they
5 have been formally noticed?

6 A. That's correct.

7 Q. You are familiar with the content of auditor integrity,
8 right?

9 A. Yes.

10 Q. That's sort of the backbone of what it means to be an
11 auditor?

12 A. That, I agree.

13 Q. What protects the capital markets is the trust that can be
14 placed in an auditor?

15 MR. BOXER: Objection.

16 THE COURT: Sustained.

17 BY MS. MERMELSTEIN:

18 Q. Part of auditor integrity is an auditor's behaving with
19 integrity in a truthful fashion, right?

20 MR. BOXER: Objection.

21 THE COURT: Overruled.

22 THE WITNESS: I agree.

23 BY MS. MERMELSTEIN:

24 Q. If the PCAOB asked an auditor to provide information about
25 how the audit firm was improving audit quality, the auditor is

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Hanson - cross

1 obligated to provide a truthful answer, right?

2 A. I agreed.

3 Q. An audit firm can't hide from the PCAOB that they've
4 devoted extra resources to certain audits based on the
5 possession of confidential PCAOB information, right?

6 MR. BOXER: Objection.

7 THE COURT: Overruled.

8 THE WITNESS: I agree with that statement.

9 BY MS. MERMELSTEIN:

10 Q. And that's true even if the extra resources devoted to
11 those audits are designed only to improve documentation, right?

12 A. I would agree with that.

13 MS. MERMELSTEIN: Nothing further.

14 THE COURT: All right. Anything further?

15 MR. WEDDLE: I have one question, your Honor.

16 THE COURT: Okay. Mr. Weddle.

17 CROSS EXAMINATION

18 BY MR. WEDDLE:

19 Q. Good morning, Mr. Hanson. My name is Justin Weddle. I
20 represent Jeffrey Wada in this case.

21 A. Okay.

22 Q. You were talking about auditor integrity. Is it fair to
23 say that auditor integrity is a higher a standard than the bear
24 minimum required by the criminal law?

25 MS. MERMELSTEIN: Objection, your Honor.

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Hanson - redirect

1 THE COURT: Sustained.

2 MR. WEDDLE: Thank you, your Honor.

3 THE COURT: Mr. Boxer?

4 MR. BOXER: Thank you, your Honor.

5 May I approach, your Honor?

6 THE COURT: Yes.

7 REDIRECT EXAMINATION

8 BY MR. BOXER:

9 Q. Showing you, Mr. Hanson, what will be marked as M-314. Do
10 you recognize that document?

11 MS. MERMELSTEIN: Your Honor, objection to the
12 relevance of this.

13 MR. BOXER: I think it's highly relevant in light of
14 the cross, your Honor.

15 Q. Do you recognize it?

16 A. I recognize the document.

17 Q. I'm sorry?

18 A. Yes.

19 Q. And what is it?

20 A. It is a subpoena to testify at a hearing or trial in a
21 criminal case for Mr. Middendorf.

22 MR. BOXER: I offer it, your Honor.

23 MS. MERMELSTEIN: Objection, your Honor, to the
24 relevance.

25 MR. BOXER: I think I will establish it, your Honor.

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Hanson - redirect

1 THE COURT: I think I am going to reserve on that.

2 Do we need to have a side bar?

3 MS. MERMELSTEIN: I think we would like to understand
4 where this is going, your Honor.

5 MR. BOXER: I have a couple more questions which I
6 think will make it clear.

7 MS. MERMELSTEIN: I think we prefer to have a proffer
8 of where it is going first, your Honor.

9 THE COURT: Go ahead and ask your question.

10 BY MR. BOXER:

11 Q. Have you and I met before today?

12 A. No.

13 MS. MERMELSTEIN: Objection, your Honor. We would
14 like a side bar, please.

15 THE COURT: Okay. Side bar.

16 (Continued next page)

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Hanson - redirect

1 (At side bar)

2 MR. BOXER: Your Honor, the witness didn't meet with
3 us even though it is our subpoena, we are the ones who brought
4 him here. He met with the government, he prepared with them.
5 He was asked a series of questions related to the allegations
6 in the indictment. I think it is relevant to the weight of his
7 evidence that they were able to meet and prepare with him and I
8 didn't.

9 It is very simple.

10 MS. MERMELSTEIN: Well, first of all, it is completely
11 inaccurate to suggest that he was unable to meet with this
12 witness. He never asked to meet with the witness, as I
13 understand it.

14 MR. BOXER: How does Ms. Mermelstein know what I asked
15 or didn't ask?

16 THE COURT: The notes were based --

17 MS. MERMELSTEIN: The notes were from an investigator,
18 I believe, who met with him, not counsel.

19 That is my understanding.

20 MR. BOXER: Yes.

21 THE COURT: So someone on your team met with him?

22 MR. BOXER: The investigator met with him, spoke with
23 him, served him the subpoena, and then before testifying he met
24 with the government and they prepared him for his testimony, at
25 least for the questions they were going to ask.

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Hanson - redirect

1 So, I think that's relevant. It is nothing more --

2 THE COURT: So this is a defense subpoena, right? So.

3 MR. BOXER: Yes. They didn't call a PCAOB board
4 member. We did. And this was our subpoena to have him appear.

5 THE COURT: It is just about the prep. I don't see
6 why it's --

7 MS. MERMELSTEIN: I think it is completely irrelevant
8 that a witness that was called by the defense also agreed to
9 meet with the government, your Honor. They called this
10 witness.

11 I think it is misleading to suggest that somehow he
12 didn't meet with the defense. He met with the government.
13 They never asked to meet with him and he would, it is my
14 understanding from discussions with his counsel, haven't met
15 with the defense. So, I think it is misleading and I don't
16 think it is proper impeachment of their own witness.

17 MR. BOXER: I don't think it's impeachment. To the
18 extent it is impeaching the answers that he answered on cross
19 it shows that they were able to prepare him. That's it.

20 MS. MERMELSTEIN: If it is not impeachment what is its
21 relevance? Isn't the only possible relevance to suggest his
22 answers to the government were somehow tainted because he met
23 with the government?

24 MR. BOXER: Fair.

25 MS. MERMELSTEIN: It has such minimal probative value

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Hanson - redirect

1 your Honor is going to instruct the jury it is not at all
2 unusual -- your Honor is going to instruct the jury that it is
3 not at all unusual for lawyers to meet with witnesses. The
4 only purported probative value is to impeach his testimony on
5 cross by suggesting that it was prepared with the government
6 and --

7 THE COURT: That is the probative value, I think.

8 MS. KRAMER: Your Honor, may I add one thing?

9 We are unable to recross on this because we can't ask
10 this witness about communications he had with his counsel.
11 Right? So, we can't really ask this witness, well, did
12 Mr. Boxer, did the defense ask to meet with you?

13 THE COURT: Why can't you ask that?

14 MS. KRAMER: I assume his knowledge is based on what
15 he learned from counsel which is protected by privilege,
16 communications with counsel. So we understood, we were trying
17 to figure out if the witness is actually testifying that these
18 discussions happened. So, it creates a misleading impression
19 that we are barred from correcting because of the
20 attorney-client privilege.

21 MR. BOXER: It is simply a fact he met with them, he
22 was prepared by them.

23 MS. MERMELSTEIN: But you are suggesting.

24 MR. BOXER: I'm not suggesting they did something
25 wrong or improper. I am saying, yes, it is impeachment of the

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Hanson - redirect

1 cross and undermines, it impeaches it. And if it's such of
2 minimal value then I don't get why we are standing here and
3 they care so much.

4 MS. MERMELSTEIN: I think it is prejudicial and of
5 minimal probative value. That's why we are standing here.

6 THE COURT: Well, I think it is fair game.

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Hanson - redirect

1 (In open court)

2 THE COURT: M-314 is received.

3 (Defendant's Exhibit M-314 received in evidence)

4 BY MR. BOXER:

5 Q. Is the reason you are testifying here today because you
6 received M-314?

7 A. Yes.

8 Q. And have you and I met before to discuss your testimony
9 today?

10 A. No.

11 Q. And, have you met with Ms. Mermelstein with respect to your
12 testimony before today?

13 A. Yes.

14 Q. You mentioned EC 9. What do you understand EC 9 to
15 provide?

16 A. Without having it in front of me, it is a simple statement
17 obtained in the course of, as my personal role as a board
18 member or employee at the PCAOB, is confidential.

19 Q. And, on the occasion where you handed over or displayed an
20 agenda that KPMG had not yet received during your meeting with
21 Mr. Middendorf --

22 MS. MERMELSTEIN: Object to misstating his testimony.

23 THE COURT: Please rephrase.

24 BY MR. BOXER:

25 Q. Did you violate EC 9 in the instance where KPMG had not

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Hanson - redirect

1 received the agenda or discussed the draft agenda with
2 Mr. Middendorf?

3 A. No.

4 Q. Why is that?

5 A. I had the draft that I believed should be the agenda and
6 discussed my views on that but did not represent it as a board
7 agenda, represented as my personal agenda.

8 Q. You informed Mr. Middendorf that what I'm telling you is
9 just my personal view?

10 A. I don't specifically recall that but just my general
11 practice would have been to issue a disclaimer that I always
12 did when speaking publicly and to others that it was my own
13 personal view.

14 Q. So, you don't know whether you told Mr. Middendorf that
15 "this was just my personal view" at the time in that meeting?

16 A. I don't recall explicitly doing that.

17 Q. And you don't believe you violated EC 9 because you --
18 well, withdrawn.

19 At that meeting were you sharing non-public
20 information with Mr. Middendorf, non-public information from
21 the PCAOB?

22 A. No.

23 Q. It was just information coming from your head?

24 A. That's correct.

25 Q. And it had no bearing and no relationship to any PCAOB

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Hanson - redirect

1 information. That's your testimony?

2 A. Well, any PCAOB information. That's a very broad
3 statement.

4 Q. I'm asking that question. Did you think what you shared
5 with Mr. Middendorf at Regan Airport that day had any bearing
6 on information belonging to the PCAOB?

7 A. It was my personal -- no. It was my personal view of what
8 I thought should be on the agenda.

9 Q. And there were no discussions with your fellow board
10 members at that point about what should be on the agenda?

11 A. I don't specifically recall but I believe the board
12 pre-meeting had happened by the time I met with Mr. Middendorf.

13 Q. So, your testimony is that nothing from the board
14 pre-meeting informed your discussion with Mr. Middendorf at
15 Regan Airport; is that correct?

16 A. The information I gathered from the pre-meeting informed my
17 personal views.

18 Q. And you don't remember whether you told Mr. Middendorf that
19 we had the pre-meeting, it informed my personal views, but
20 these are my personal views, sort of take it for that?

21 A. I don't recall those specific words.

22 Q. Is it fair to say that you were left with the impression
23 that Mr. Middendorf was given a heads up as to what was going
24 to be discussed at the board meeting?

25 MS. MERMELSTEIN: Objection.

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Hanson - redirect

1 THE COURT: Overruled.

2 THE WITNESS: Well, he was after the impression of my
3 personal views about the agenda.

4 BY MR. BOXER:

5 Q. Which you don't recall whether you said personal views or
6 not?

7 A. I don't personally recall that discussion.

8 Q. I see.

9 In the e-mail we looked at -- if we could display
10 M-130? At the bottom of M-130, the beginning of the second
11 paragraph you write: We have not had our internal prep meeting
12 yet; correct?

13 A. That appears to be what I wrote, yes.

14 Q. And you wanted to have that internal prep meeting before
15 the meeting with Mr. Middendorf occurred, right?

16 A. Correct.

17 Q. So, when you spoke to Mr. Middendorf after the internal
18 prep meeting you would be able to share with him information
19 from that prep meeting, right?

20 MS. MERMELSTEIN: Objection to all the leading.

21 THE COURT: Sustained.

22 BY MR. BOXER:

23 Q. What was the reason why you wanted to have the call with
24 Mr. Middendorf after you had the internal prep meeting?

25 A. So I was best informed as to what the current status of the

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Hanson - redirect

1 inspection was and the other things that the staff had the
2 ability to share with me.

3 Q. And on that call after the internal prep meeting, did you
4 say anything to Mr. Middendorf about whether you were sharing
5 your personal view or the board's view?

6 A. Well, I don't recall in this particular call if he had the
7 agenda or not so I don't recall having that discussion.

8 Q. If he had the agenda -- withdrawn.

9 You mentioned that you had previously said the
10 documentation period was, I think the words you were asked,
11 putting a bow on it. Is that correct?

12 A. I believe that I agreed that's what I said.

13 Q. Did you tell Mr. Middendorf that you viewed the
14 documentation period as putting a bow on the audit workpapers?

15 A. I don't recall having a discussion with him.

16 Q. Are you familiar with AS 3?

17 A. I generally am aware of what AS 3, what the topic is.

18 Q. It is an auditing standard?

19 A. That's correct.

20 Q. Issued by the PCAOB, correct?

21 A. That's correct.

22 Q. While you were a board member it was in effect, right?

23 A. It was in effect when I was a board member.

24 Q. That was my question.

25 A. Yes.

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Hanson - cross

1 Q. And, what do you understand it to be?

2 A. I understand it is a board standard that addresses the need
3 for and some guidance as to what should be in documentation of
4 audit procedures performed and when it should be prepared.

5 Q. And, does AS 3 permit an auditing firm to document work
6 that it had performed before the audit was closed?

7 A. Does it permit?

8 Q. Yes. Is an auditing firm allowed to, for example, draft
9 the memo describing work that it had performed during the audit
10 before the audit opinion was issued?

11 A. Yes.

12 Q. And AU 390, I think you mentioned that as well on your
13 cross. Do you know what AU 390 is? Maybe you didn't mention
14 it.

15 A. I don't remember being questioned about AU 390.

16 Q. Do you know what AU 390 is?

17 A. No. Refresh my memory.

18 Q. That's fine. If you don't know what it is, that's fine --

19 A. I mean I --

20 MR. BOXER: I have nothing further, your Honor.

21 THE COURT: Anything further?

22 MS. MERMELSTEIN: Very briefly, your Honor.

23 CROSS EXAMINATION

24 BY MS. MERMELSTEIN:

25 Q. Good afternoon, again, Mr. Hanson.

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Hanson - cross

1 You were asked questions about speaking to the
2 government before your testimony here today. Just to
3 clarify --

4 MR. BOXER: Objection to the conversation.
5 Irrelevant.

6 THE COURT: Sustained.

7 BY MS. MERMELSTEIN:

8 Q. Prior to testifying here today, you were first contacted by
9 representatives of the defense team for Mr. Middendorf, right?

10 A. That's correct.

11 Q. And you were interviewed by a representative of the defense
12 team for Mr. Middendorf, right?

13 A. Yes.

14 Q. And then, in advance of testifying here today and without
15 asking you to share with the jury anything your counsel said to
16 you, but Mr. Boxer relayed questions about what you would say
17 to certain things to your counsel and answers were provided to
18 Mr. Boxer, right?

19 MR. BOXER: Objection. The question asked for his
20 communications with his counsel.

21 THE COURT: Sustained.

22 BY MS. MERMELSTEIN:

23 Q. Leaving out counsel, you understand that representations
24 were made to Mr. Boxer about what you would say to certain
25 questions, right?

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Hanson - cross

1 MR. BOXER: Objection. Same objection.

2 THE COURT: Sustained.

3 Q. Mr. Boxer never asked to meet with you himself, in person;
4 right?

5 MR. BOXER: Objection.

6 THE COURT: Overruled.

7 A. That's what I understand.

8 Q. You were equally willing to meet with any of the parties to
9 this case; is that fair?

10 A. That's correct.

11 MS. MERMELSTEIN: Nothing further.

12 MR. BOXER: Nothing further.

13 THE COURT: Okay. Thank you, sir. You may step down.

14 THE WITNESS: Your Honor, I still have this --

15 MR. BOXER: I will take it.

16 May I approach?

17 THE COURT: Yes.

18 Do you guys need a break?

19 THE JURY: Yes.

20 THE COURT: Well, the Judge needs a break so we are
21 going to take 10 minutes, folks. Please leave your pads on
22 your chairs.

23 (Jury not present)

24 (Recess)

25 (Continued next page)

J34dmid3

(Jury not present)

THE COURT: Who is the next witness?

MS. LESTER: Your Honor, we have a stipulation that we are going to read into the record, and the next witness is Paul Atkins.

THE COURT: OK.

MS. LESTER: We could put the witness on the stand.

THE COURT: How long is the stipulation?

MS. LESTER: It is pretty short.

THE COURT: OK. We can go ahead and do that.

Anything else we need to address before we bring the witness and the jury in?

OK. We can get the witness.

Sir, you can come on up to the witness stand.

(Witness present)

(Continued on next page)

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(Jury present)

THE COURT: Please be seated, folks.

Welcome back, ladies and gentlemen. We're continuing with the evidence in the trial.

And Ms. Lester.

MS. LESTER: Your Honor, at this time we'd like to read a stipulation that's marked for identification as Exhibit M211.

THE COURT: All right.

MS. LESTER: Ladies and gentlemen, the stipulation is between the parties and it reads as follows:

"On December 21, 2018, the Public Company Accounting Oversight Board ("PCAOB") received a subpoena requesting the production of all KPMG-related PCAOB 4004 reports related to KPMG inspections that the PCAOB submitted to the SEC for the period January 1, 2013 to February 10, 2017.

"In January 2019, in response to the subpoena, the PCAOB produced three 4004 reports. No other 4004 reports were produced by the PCAOB in response to the subpoena.

"The three 4004 reports produced by the PCAOB in response to the subpoena have been marked as Defense Exhibits M207, M208, and M209.

"It is further stipulated and agreed that this stipulation, marked as Defendant Exhibit M211, is admissible in evidence at trial.

J34dmid3

Atkins - direct

1 Thank you, your Honor.

2 At this time, the defense calls Paul Atkins.

3 (Defendant's Exhibit M211 received in evidence)

4 THE COURT: All right. Mr. Atkins is on the witness
5 stand.

6 Sir, if you would please raise your right hand, you
7 will be sworn in by the courtroom deputy, Mr. Hampton.

8 PAUL STUART ATKINS,

9 called as a witness by defendant Middendorf,

10 having been duly sworn, testified as follows:

11 THE CLERK: Please state your full name and spell your
12 last name slowly for the record.

13 THE WITNESS: Paul Stuart Atkins, A-t-k-i-n-s.

14 THE CLERK: Thank you.

15 DIRECT EXAMINATION

16 BY MR. BRUCH:

17 Q. Good morning, Mr. Atkins. I'm Greg Bruch, counsel for
18 David Middendorf.

19 Could you describe your educational background for the
20 jury?

21 A. I went to college at Wofford College, in Spartanburg, South
22 Carolina, studied -- I double majored in accounting and English
23 literature, and then went to law school straight out after
24 that.

25 Q. Did you graduate from law school?

J34dmid3

Atkins - direct

1 A. In 1983.

2 Q. OK. What was your first job after you got out of law
3 school?

4 A. I worked here in Manhattan at Davis Polk & Wardwell, a law
5 firm.

6 Q. Can you generally describe what you did there?

7 A. Well, I was what we call a corporate associate. I worked
8 on securities transactions, mergers and acquisitions, new
9 products for investment advisors and generally SEC-related type
10 of law work.

11 Q. How long did you work at Davis Polk & Wardwell?

12 A. For six years.

13 Q. What came next for you? What job did you take next?

14 A. I went to Washington, D.C. I worked at the Securities and
15 Exchange Commission in the Chairman's office as an attorney
16 fellow.

17 Q. How long did you work as an attorney fellow?

18 A. A couple of years or so until the Chairman asked me to be
19 his Chief of Staff.

20 Q. So you were Chief of Staff to the then Chairman of the SEC.
21 Who was that?

22 A. Richard Breeden.

23 THE COURT: Richard?

24 THE WITNESS: Breeden, B-r-e-e-d-e-n.

25 THE COURT: Thank you.

J34dmid3

Atkins - direct

1 BY MR. BRUCH:

2 Q. How long were you Chief of Staff?

3 A. Well, he left in May '93. So it was maybe about a year or
4 something like that.

5 Q. Did you stay at the SEC after Mr. Breeden left?

6 A. Yes. After the election occurred in whenever that was,
7 1992, and Richard was asked to stay on by the incoming Clinton
8 Administration and Arthur Levitt was nominated the Chairman, so
9 Arthur called me after that and asked me to stay on when he
10 came to be Chairman.

11 Q. OK. When did you leave the SEC?

12 A. In November 1994.

13 Q. What job did you go to at that point?

14 A. I joined Coopers & Lybrand as a principal.

15 Q. What kind of firm was Coopers & Lybrand?

16 A. It was an accounting firm.

17 Q. Did the name of Coopers & Lybrand change while you were
18 there?

19 A. Yeah. It merged with Pricewaterhouse and now it is called
20 PriceWaterhouseCoopers.

21 Q. And PriceWaterhouseCoopers is one of the Big Four
22 accounting firms?

23 A. Yes.

24 Q. Did you work as an accountant at PriceWaterhouseCoopers?

25 A. No, I have an accounting degree, but I never became a CPA,

J34dmid3

Atkins - direct

1 I went straight to law school, and so I was the equivalent of a
2 partner in the firm and a principal.

3 Q. Can you briefly describe your work at
4 PriceWaterhouseCoopers?

5 A. Well, I worked with a group that dealt with regulatory
6 issues for financial services firms, so for broker-dealers and
7 asset managers like mutual funds. So we did things like mock
8 SEC examinations and helped them with compliance issues that
9 they had to try to -- help them stay out of trouble, basically,
10 so they could do the right thing with respect to compliance.

11 Q. Did you follow SEC developments closely during that period?

12 A. Yeah, it was part of the job.

13 Q. Did there come a time when you left PriceWaterhouseCoopers
14 for another job?

15 A. I did. In 2002, I was nominated to be Commissioner of the
16 Securities and Exchange Commission by the President and was
17 confirmed by the Senate in 2002.

18 Q. So, how many commissioners are there at the SEC?

19 A. Five, five commissioners.

20 Q. You one of the five commissioners nominated by the
21 President. How long did you serve as a commissioner?

22 A. For six years.

23 Q. Six years. Can you generally describe your duties as a
24 commissioner of the SEC?

25 A. Well, so the SEC is a government agency, of course, and

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Atkins - direct

1 there are about 4600 people. There are five what we call
2 officers of the United States, meaning the five commissioners
3 are the ones who are appointed by the President and confirmed
4 by the Senate, and so they act as the governing body of the
5 agency. And they approve as a body the rules of the SEC, and
6 then they sit as a body to decide whether or not to sue
7 somebody or, you know, an enforcement action and that sort of
8 thing, or they sit as an appellate body for if there are
9 appeals from organizations that report to the SEC where people
10 make appeals to the. But -- and then there are of course, as I
11 mentioned, 4600 or so employees and so they report to the
12 Chairman of the agency.

13 Q. OK. So your tenure at the SEC was what years? 2002
14 through when?

15 A. August 2002 and I left in August of 2008.

16 Q. During 2000 -- your tenure as a commissioner at the SEC,
17 was there any major legislation passed that affected the work
18 of the SEC?

19 A. Yeah. Right as I was coming aboard, there was a statute
20 enacted, called the Sarbanes-Oxley Act. So that was in July or
21 so of 2002, about ten days before I was confirmed. And so we
22 had to -- that was the big deal there for the first couple of
23 years was to try to implement the legislation, because Congress
24 passes a statute and then it directs agencies like the SEC to
25 come up with rules to implement what the statute says.

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Atkins - direct

1 Q. Was one of the components of Sarbanes-Oxley the Public
2 Company Accounting Oversight Board?

3 A. Yes. That was one of the main things that came out of that
4 legislation.

5 Q. Were there other things in Sarbanes-Oxley that had nothing
6 to do with the Public Accounting Oversight Board?

7 A. Sure. There were directives to the SEC with respect to
8 rules that we needed to adopt for public companies. There were
9 things that affected stock exchanges and that sort of thing,
10 directives like, for example, an audit committee of a public
11 company had to be all independent directors. So, there were a
12 lot of things in Sarbanes-Oxley.

13 Q. So you left the SEC in 2008. What was your next job?

14 A. I took off some time, a few months, and then I was asked to
15 be by the -- appointed by the Senate of the United States to be
16 on the Congressional Oversight Panel for the Troubled Asset
17 Relief Program, the TARP program. So this was a body of a size
18 similar to the SEC, but we were to oversee what Treasury was
19 going to do with the TARP money with respect to the banking
20 system after the financial crisis.

21 Q. And did you take a private sector job as well after you
22 left the SEC?

23 A. At the same time, I started the firm that I am with now,
24 Patomak Global Partners.

25 Q. What is your position at Potomak?

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Atkins - direct

1 A. I am the Chief Executive.

2 Q. What does Potomak do? Can you describe that in a brief
3 way?

4 A. Well, we -- similar to what I described I did at
5 PriceWaterhouseCoopers, we try to help companies stay out of
6 trouble by being in compliance with all the various regulations
7 that they have to deal with, so be they the SEC, the CFTC,
8 banking regs, so mainly we, you know, help brokerage houses,
9 mutual funds and their advisors, banks and insurance companies
10 and then public companies with respect to SEC, CFTC and those
11 sorts of regulations, and help them with new products. If they
12 get in trouble, try to help them deal with the issues, whether
13 it be litigation or enforcement or that sort of thing.

14 Q. Have you had any employment where you have been appointed
15 by any government agencies?

16 A. Yes. So I've been asked to be -- or in fact by this court
17 to be a monitor with respect to a bank that had issues with the
18 reporting of transactions to the Commodities Futures Trading
19 Commission as being what is called an independent compliance
20 consultant in the wake of enforcement actions by the SEC, the
21 CFTC, the Federal Reserve, the Department of Justice, that sort
22 of thing.

23 Q. In the most recent presidential election, did you have any
24 role with respect to the changing of the guard at the
25 regulatory agencies?

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Atkins - direct

1 A. Yeah. For the -- after the convention, I was asked to help
2 with the transition for what became the current President. But
3 every -- the law requires both candidates to plan for the
4 eventuality of perhaps winning the election so you don't start
5 off thinking, oh, my gosh, where do I go from here. So we
6 planned for -- at least my role was to look at the independent
7 financial agencies so that it doesn't -- mainly financial
8 services agencies to figure out, you know, what was going on at
9 them, what the policy issues would be, and then to maybe start
10 thinking about personnel to fill the various spots.

11 Q. So how do you currently stay informed of SEC practices,
12 policies, procedures, and the like?

13 MS. KRAMER: Objection, your Honor.

14 Q. Do you stay informed of SEC current policies and
15 procedures?

16 A. Yes, I have to to do my job.

17 Q. Can you describe how you stay informed?

18 A. Well, by of course reading and following what goes on at
19 the agencies, because it is not just SEC but it is others. We
20 have a number of people who produce memoranda for clients about
21 new events and new regulations that are being adopted or
22 considered. I participate in conferences as a speaker or --
23 and then also like one of the main ones is called SEC Speaks
24 where as a former commissioner I am asked to be on various
25 panels that deal with issues, and so we're supposed to give

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Atkins - direct

1 feedback to the staff and the commissioners as to, you know,
2 various things that come up. So I try to stay involved that
3 way. I know obviously the various commissioners at the
4 different agencies. So, you know, there are a lot of things
5 that are going on in Washington, obviously, at the various
6 agencies.

7 Q. As a result of your professional experience, are you
8 familiar with the SEC's oversight function with respect to the
9 PCAOB?

10 A. Yes.

11 Q. Have you previously testified as an expert?

12 A. Yes.

13 Q. How many times? Do you have an approximate number?

14 A. Well, in a court only a handful, maybe three or four, but
15 as an expert with reports on the civil side, about 15 over the
16 last ten years.

17 Q. When you say on the civil side, do you mean lawsuits
18 between private actors?

19 A. Right.

20 Q. OK. And can you briefly describe the subject matter of
21 your prior testimony -- subject matters, generally?

22 MS. KRAMER: Objection to relevance, your Honor.

23 Q. Can you describe to the jury your hourly rate?

24 A. This matter is 1450.

25 Q. And in your practice, is that a market rate for you?

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Atkins - direct

1 A. Yeah, formally for a matter like this, expert testimony.

2 Q. So let me ask you some questions about the SEC.

3 Can you briefly describe for the jury when the SEC was
4 established?

5 A. In 1934, after the stock market crash of 1929, a number of
6 statutes were enacted by Congress, the Securities Exchange Act,
7 and that's what established the SEC as an agency.

8 Q. What is the SEC's mission, if you know?

9 A. Well, the statute has a three-part mix. The first part is
10 investor protection, to try to make sure that there is good
11 information in the marketplace and that investors can rely on
12 that information, among other things, and to try to keep bad
13 actors out of the markets, and then to facilitate fair and
14 orderly and efficient markets, meaning stock exchanges
15 primarily, and then finally to promote capital formation,
16 because that's the reason why companies sell stock is to raise
17 money so that they can hire people and build factories and that
18 sort of thing.

19 Q. Does the SEC -- SEC's mission extend to the regulation of
20 public companies?

21 A. Yes, that's one of the primary groups of entities that it
22 oversees.

23 Q. Do you know approximately how many public companies there
24 are?

25 A. There are about 3600 now that are registered and have their

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Atkins - direct

1 securities listed, which is about half of what it was 20 years
2 ago, but anyway.

3 Q. Do the 3600 public companies file documents with the SEC?

4 A. Yes, a fair number of them. They have to file annual
5 reports of their financial results and quarterly reports as
6 well and then other things in similar ways.

7 Q. Is the SEC staff expected to review the filings public
8 companies make with the SEC?

9 A. Yeah. There is a division of corporation finance that
10 looks at filings of public companies and then does some
11 management, looks at filings of mutual funds, and so those are
12 two primary --

13 Q. Can you give us a sense of the scale of the SEC, how many
14 employees?

15 A. Today it's about 4600.

16 Q. And located in a number of offices?

17 A. Yeah. Well, there is a home office in Washington, and then
18 there are about a dozen regional offices scattered about.

19 Q. And can you give us a sense of what the current budget is
20 for the SEC?

21 A. It is about a billion-and-a-half dollars or so.

22 Q. That is a billion with a B?

23 A. With a B, right.

24 MR. BRUCH: OK. I would like to publish for the
25 witness and for counsel M305.

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Atkins - direct

1 Q. I just ask you if you have seen this document before?

2 A. Yes. This is an organization chart of the Securities and
3 Exchange Commission.

4 MR. BRUCH: I would move this for admission, your
5 Honor.

6 MS. KRAMER: If we could just get a clarification of
7 the timeframe for this document?

8 MR. BRUCH: Certainly.

9 BY MR. BRUCH:

10 Q. Do you know when this document -- does it appear to be a
11 current document, a current representation of the SEC?

12 A. It does, yes.

13 MS. KRAMER: No objection.

14 THE COURT: M305 is received.

15 (Defendant's Exhibit M305 received in evidence)

16 BY MR. BRUCH:

17 Q. So if you look at M305, can you describe what this document
18 purports to be?

19 A. Well, it shows -- well, as I described, if you look at the
20 top row, you see the Commission. So those are the five
21 commissioners. And so they sit, again, as a governing body,
22 adopting rules and deciding what actions the SEC is going to
23 take.

24 In the middle you see the Chairman and the Chairman's
25 office. So, there is one line going down. So, according to

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Atkins - direct

1 the statutes, since President Truman's days, the entire staff
2 reports to the Chairman. He has the oversight of the budget
3 and over the human resources aspect of the agency.

4 Q. OK.

5 A. He has to go to the commissioners to get approval for
6 various actions that the agency takes.

7 Q. OK. Can you describe of all these boxing which of these
8 boxes represent the largest operating units of the SEC?

9 A. Well, the next tier down after the commission, so if you
10 look at the far left where it says "enforcement," so that is
11 the Enforcement Division. So, that is the largest division.
12 It has about 1500 of the 4600 people.

13 If you go all the way to the right, where it says
14 "Compliance Inspections and Examinations," that's the second
15 biggest, and so they are the ones who do inspections and
16 examinations of registered entities.

17 Q. OK. Let's go to "Enforcement."

18 What does the Division of Enforcement do?

19 A. It's a division that has think of it as litigators.
20 Basically people who do -- who bring cases against people that
21 they allege have violated the rules and regulations of the SEC,
22 and so there is a process. And they bring about, say, 800-ish
23 cases a year 7/800, something like that, and most of them are
24 settlements. They don't all go to trial. By far, most of them
25 are settled matters.

J34dmid3

Atkins - direct

1 Q. Do you know whether they bring actions against auditors of
2 public companies?

3 A. They can, yes.

4 Q. They can. Do you have an approximate sense of how
5 frequently the Division of Enforcement brings auditor cases
6 from the Enforcement Division?

7 MS. KRAMER: Objection. Vague as to timeframe.

8 THE COURT: You can specify as to timeframe.

9 Q. Do you have a sense of within the past five years, roughly,
10 how many days cases have been brought by the Division of
11 Enforcement against auditors of public companies,
12 approximately?

13 A. Yeah. Say against the Big Four, it might be about one a
14 year or so, the Big Four accounting firms, and against all
15 accounting firms, it's, you know, a few every year.

16 Q. And that's out of approximately 800 cases per year filed by
17 the Division?

18 A. Yes, 7 or 800.

19 MS. KRAMER: Objection to the leading, your Honor.

20 THE COURT: Overruled.

21 BY MR. BRUCH:

22 Q. And you have talked about the box on the far right, the
23 "Compliance Inspections and Examinations." What does that
24 organization do?

25 A. So that's a group that looks after -- or does examinations

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Atkins - direct

1 of investment advisors, so like if you think of Fidelity or
2 Vanguard or the big mutual fund firms. So, these are called
3 registered investment advisors. So you register as an
4 investment advisor with the SEC. So the SEC goes in and
5 examines them to see if they are operating their business
6 according to the rules. And they also look at broker-dealers,
7 so brokerage houses like Merrill Lynch or Morgan Stanley or
8 whatever. And they also look at stock exchanges like the New
9 York Stock Exchange or NASDAQ. Similarly to that, they look at
10 transfer agents. So there are a whole bunch of different types
11 of entities.

12 Q. I am going to try to ask you a contextual question.

13 Approximately how many registered investment advisors
14 are there that report to the SEC, if you know?

15 A. About probably 15,000. It is more than 10,000, anyway. I
16 don't know what the current number is but it is a lot.

17 Q. So the Office of Compliance Inspections and Examinations,
18 to your knowledge, conducts no inspections or examinations of
19 the public auditing business, is that correct?

20 A. Right. It's -- that's left to the PCAOB.

21 Q. OK. The Division of Corporation Finance, that is the box
22 that is second from the left, do you see that?

23 A. Yes.

24 Q. Do you know approximately how many -- what does the
25 Division of Corporation Finance do, if you know?

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Atkins - direct

1 A. Well, they are the ones -- when we talk about the 3600 or
2 so public companies, they are the ones that look at their
3 registration statements if they are going to issue new stock.
4 They look at their annual what's called a 10-K, the annual
5 report that has their annual, you know, statement of earnings
6 and that sort of thing. So, they have to look at all of those
7 filings.

8 And then besides the 3600 companies, there are a
9 number of other what we call reporting entities, so people --
10 companies that don't necessarily have listed stocks. So all in
11 all, Corporation Finance has probably about 8,000 entities that
12 they need to keep up with and so it's like a machine where they
13 review things, give comments on, and so they have a lot of work
14 to do.

15 Q. OK. Are you familiar with something called a
16 self-regulatory organization?

17 A. Yes.

18 Q. Does that play a role in what the SEC's work is?

19 A. Yeah. Well, a part of the statutes, going back to 1934,
20 allows entities to be the self-regulatory entities, which are
21 membership organizations, so think of the New York Stock
22 Exchange or organizations of brokers. So they adopt their own
23 rules, but they're under the oversight of the SEC, because the
24 rules have to be approved by the SEC, and the SEC, you know,
25 examines them as to how they are abiding by the law.

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Atkins - direct

1 Q. Do you know if there is a form of self-regulatory
2 organization called Financial Industry Regulatory Authority?

3 A. Yes. "FINRA" for short.

4 Q. Can you give us a sense of how large the industry is that
5 FINRA regulates?

6 MS. KRAMER: Objection to relevance, your Honor.

7 THE COURT: Overruled.

8 A. Yes. Well, FINRA has something -- it is like 700,000
9 registered representatives. So these are think of your, if you
10 ever have met a broker at Morgan Stanley or something like
11 that, each broker is a registered representative and has to
12 pass a test that FINRA administers the whole series of
13 different tests, and so FINRA oversees those at about 3700
14 brokerage firms. So, the big ones that you have heard of but
15 then there are lots of smaller ones, and so FINRA has all of
16 those to look after as well.

17 Q. Do you know whether FINRA has an inspection function of its
18 member firm activity?

19 A. Very large, to look after all of those people, yes.

20 Q. OK. Is the PCAOB a self-regulatory organization?

21 A. No. The PCAOB is formed separately. There is some -- it's
22 analogous, it is similar in a way to self-regulatory
23 organizations, but the PCAOB was set up by the Sarbanes-Oxley
24 Act to be specifically not a self-regulatory organization
25 because it doesn't have a membership. It's basically a

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Atkins - direct

1 regulatory organization over the accounting industry.

2 Q. OK. And of the pure self-regulatory organizations,
3 approximately how many are there that report to the SEC?

4 A. Probably it's fewer than 50. It is like 46 or so, at the
5 last count, I think. So those are all the stock exchanges,
6 FINRA, you know, other sorts of clearing corporations and
7 things like that, so.

8 Q. So the PCAOB is not a self-regulatory organization. Can
9 you describe what characteristics there are of the PCAOB?

10 A. Well, so similar to the SEC, it has a board of five members
11 that are appointed by the commissioners of the SEC. And they
12 have a staggered term; one term expires -- one term of each
13 board member expires every year. And only two of the five can
14 actually be accountants, can be CPAs. So it was meant to be --
15 by Congress to be an independent body that doesn't really have
16 any, you know, connection to the accounting industry.

17 Q. Can you -- do you have an opinion, do you have knowledge
18 why -- sorry. Let me take that back.

19 In the Sarbanes-Oxley Act, did Congress delegate
20 oversight of independent auditors to the PCAOB?

21 MS. KRAMER: Objection, your Honor. It calls for a
22 legal conclusion.

23 MR. BRUCH: I will withdraw the question, your Honor.

24 THE COURT: OK.

25 BY MR. BRUCH:

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Atkins - direct

1 Q. What type of entity is the PCAOB?

2 A. It's a not-for-profit corporation established in
3 Washington, D.C.

4 Q. Does the PCAOB regulate the public auditing profession?

5 A. Yes.

6 Q. By public auditing, that means companies that are public
7 filers with the SEC, correct?

8 A. Right. So the auditing firms that audit public -- so it
9 called the Public Company Accounting Oversight Board because
10 auditors that audit public companies, meaning companies that
11 have sold stock to the public, that's the group that the PCAOB
12 oversees.

13 Q. OK. Does the PCAOB regulate -- an exclusive regulator of
14 the auditing profession?

15 A. Of the auditing profession, I mean, so you have auditors
16 are kind of like lawyers, they have to pass a test to become
17 certified public accountants, but that test is administered by
18 the American Institute of Certified Public Accountants, the
19 AICPA. Then every state has its own auditing board,
20 accountancy board, so they are the ones who license the
21 individual auditors to be practicing CPAs. So they are the
22 ones who have oversight over, you know, if they get out of, you
23 know, the ethics and whatnot, the restrictions and rules of the
24 particular state.

25 Q. Do auditing firms register with the PCAOB?

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Atkins - direct

1 A. Yes. So if an auditing firm audits a public company, then
2 they need -- or a broker-dealer, they need to register with the
3 PCAOB directly. So there are some firms, you know, a lot of
4 auditing firms actually that do not register with the PCAOB.

5 Q. So do you know how many firms, how many auditing firms,
6 have registered with the PCAOB?

7 A. Yeah. Offhand, I, you know -- I don't know offhand. It
8 can be really --

9 Q. Do you know if it is more than a thousand?

10 A. Yeah. It's probably around a thousand, yes, 1500,
11 something like that.

12 Q. Do you know how many employees PCAOB has?

13 A. There are about probably 800-ish, something like that.

14 Q. Are each of the firms' -- accounting firms, auditing firms
15 registered with the PCAOB subject to periodic inspection, if
16 you know?

17 A. I'm sorry. Can you say that again?

18 Q. Do you know whether each of the accounting firms, the
19 auditors registered with the PCAOB, are subject to periodic
20 inspection from the PCAOB?

21 A. Yes. The accounting firms -- yes, the PCAOB has its
22 examination function, inspection function, and does that over
23 the firms every year.

24 Q. Do you know how many inspection reports are created and
25 generated by the PCAOB every year, approximately, within the

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Atkins - direct

1 past five years?

2 A. It's a little over a hundred, probably.

3 Q. Does the PCAOB have accounting standard authority?

4 A. No. So accounting -- so you have to draw a distinction
5 between accounting, which are rules of putting together
6 financial statements, you know, whether, you know, how
7 something should be treated as, you know, expenses or whatever
8 and how you recognize revenue, versus auditing, which is how
9 does an auditor go in and, you know, examine then the
10 statements that a company has come up with that, you know, its
11 profit and loss and all of that. So those auditing standards
12 is what the PCAOB looks at.

13 Q. Do they differentiate between accounting standards and
14 auditing standards?

15 A. Yes. So that's a difference that the accounting standards
16 are overseen by another group called the Financial Accounting
17 Standards Board, which is just vaguely overseen by the SEC but
18 the SEC looks after its budget, according to the Sarbanes-Oxley
19 Act. But there is another group called the Financial
20 Accounting Foundation which is focused on the -- on FASB, it's
21 called, "FASB," the Financial Accounting Standards Board. So
22 that's more of an accounting profession-driven type of thing,
23 although the SEC does have influence over it.

24 Q. Do you know whether the PCAOB has an Enforcement Division?

25 A. It does, yes.

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Atkins - direct

1 Q. Are you familiar with the jurisdiction of the PCAOB's
2 Enforcement Division?

3 A. Yes. Well, they look after the rules that the PCAOB has
4 adopted, and they are -- so they bring cases in that regard if
5 people have violated a particular rule.

6 Q. Do you know whether they have any jurisdiction over public
7 companies themselves, "they" the PCAOB?

8 A. No. That's the SEC that does -- and the Department of
9 Justice.

10 Q. Do you know if the PCAOB has any jurisdiction over
11 investors or market participants other than auditors?

12 A. No. So they look after auditors of public companies.

13 Q. OK. Prior to the creation of the PCAOB, do you know
14 whether there was an inspection function directed at public
15 auditors, public company auditors?

16 A. Not --

17 MS. KRAMER: I am going to object to the relevance
18 of --

19 MR. BRUCH: I am trying to establish the context, your
20 Honor, with which the inspection function occurred at the
21 PCAOB.

22 THE COURT: You can answer it.

23 A. Well, before Sarbanes-Oxley was enacted, the accounting
24 profession had what's called peer review. So at the time they
25 were the Big Eight or even going farther back more than that;

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Atkins - direct

1 now there are of course the Big Four. But, anyway, the big
2 accounting firms would look at sample audits of one another and
3 then kind of critique that. And so Congress decided in the
4 wake of Enron and WorldCom, if you have heard of those
5 companies that precipitated the Sarbanes-Oxley Act in 2002,
6 Congress thought that there should be another body that was
7 statutorily set up to look after the -- what was going on with
8 respect to audits and to systematize it.

9 Q. Do you have an opinion of whether the PCAOB when it was
10 created took over any core functions of the SEC's regulation of
11 the auditing profession?

12 A. Well, basically what Congress did was delegate to PCAOB the
13 examination of the firms, the auditing firms, and as a private
14 sector entity, basically, and --

15 Q. Was that a function undertaken by the SEC prior to this
16 time?

17 A. No, it had general oversight. But before that the -- there
18 was a group called the Public Oversight Board, POB, and that
19 was a group set up by the auditing profession to oversee audits
20 and that sort of thing, so it was not the SEC.

21 Q. OK. Are you aware that the PCAOB has a process whereby an
22 auditing firm can be deregistered?

23 MS. KRAMER: Objection to the leading, your Honor.

24 THE COURT: Overruled.

25 A. Yes. So if an auditing firm doesn't meet the requirements

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Atkins - direct

1 of registration at the PCAOB, it can be deregistered.

2 Q. Have you ever seen the PCAOB take action to deregister
3 accounting firms?

4 A. Yes. When I was a commissioner one year, I can't remember,
5 '06/'07, something like that, there were a number of accounting
6 firms that had registered with the PCAOB but then they were
7 found to have been, you know, not -- so they didn't audit
8 sufficiently a number of public companies or the right size of
9 companies and so there were like a hundred or some of them I
10 think that were basically drummed out from the PCAOB.

11 Q. Would you be able to characterize the kind of firms that
12 were deregistered?

13 MS. KRAMER: Objection, your Honor.

14 THE COURT: Overruled.

15 A. Small accounting firms.

16 Q. Are you familiar with any deregistration proceedings that
17 the PCAOB has ever initiated against large accounting firms?

18 A. No.

19 Q. Are you familiar with deregistration proceedings being
20 initiated by the PCAOB against any of the Big Four?

21 A. Well, here in the last couple of years, there has been a
22 tussle with China over -- so these are the Chinese affiliates
23 of the Big Four accounting firms where they -- the SEC was
24 seeking the working papers of audits, and the Chinese
25 government wouldn't let them be produced. So the SEC, you

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1 know, started that process to try to, you know, have them not
2 be accepted in the United States. But that, you know --

3 Q. These were the Chinese accounting firms that were
4 affiliated with the Big Four, though, correct?

5 A. Exactly. And they would -- that would have created let's
6 just say havoc in the marketplace had that occurred, so the SEC
7 didn't go down that road.

8 Q. OK. And do you have an opinion of what would happen if
9 there were a deregistration proceeding against one of the Big
10 Four auditing firms?

11 MS. KRAMER: Objection, your Honor. Irrelevant and
12 speculation.

13 THE COURT: Overruled.

14 A. I can't imagine ever a Big Four accounting firm being
15 deregistered. I just -- we only have four of them, and that
16 would, again, create absolute havoc in the marketplace, because
17 we can't really -- I mean, four is about the minimum, I think,
18 of what we could have.

19 Q. Let me ask you some questions, some brief questions, about
20 the SEC's oversight of the PCAOB.

21 Does the SEC exercise oversight of the PCAOB?

22 A. Yes, that's part of its mandate.

23 Q. How would you describe that oversight?

24 A. Well, there are a lot of things the SEC has to do, but
25 mainly through the Office of Chief Accountant, the SEC looks

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1 after what the PCAOB is doing on an annual basis. It needs to
2 approve the budget, and that's probably the most important
3 function. But it looks at, you know, what the PCAOB is
4 spending and what it's business plan is and that sort of thing.

5 Q. You mentioned Office of Chief Accountant. How many -- do
6 you know how many employees there are in the SEC's Office of
7 Chief Accountant?

8 A. There are 50. Maybe 46 or 8, something like that.

9 Q. So do you know the size of the PCAOB's budget?

10 A. It's 200-and-some-odd million, 250-ish, something like
11 that.

12 Q. Do you know the source of the PCAOB's funding?

13 A. Yes. It's mainly from public companies. It is kind of a
14 wealth tax. They have to pay based on their market
15 capitalization. So if you multiply all the shares outstanding
16 times price per share, that's what you would call market
17 capitalization. And so there is a formula in the statute, in
18 the SEC rules, from which that is calculated. And then also
19 the accounting profession pays money into the budget, a smaller
20 portion, and the broker-dealers who are examined by their -- by
21 the PCAOB as well.

22 Q. When you were an SEC commissioner, were you involved in the
23 review of the PCAOB's budget?

24 A. Yes. So we looked during my first couple of years, those
25 were the beginning years of the PCAOB, and in fact I demanded

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1 that we have a public hearing to air, you know, what they were
2 going to be doing with all the money they were being given.

3 Q. In connection with that role, did you ever review a single
4 firm's PCAOB inspection report?

5 A. No.

6 Q. Are you aware of any SEC commissioner at any time that has
7 reviewed a single firm's inspection report in connection with
8 the PCAOB budget request?

9 MS. KRAMER: Objection, your Honor. Hearsay.

10 THE COURT: Overruled.

11 A. No. I can't imagine -- I doubt that ever would be part of
12 looking after the budget.

13 Q. Was one of your responsibilities as an SEC commissioner the
14 appointment of PCAOB board members?

15 A. Yes.

16 Q. Does that continue to be the responsibility of the SEC
17 commissioners?

18 A. Yes.

19 Q. When you were an SEC commissioner, did you ever review a
20 single firm's inspection report in connection with your
21 appointment of board members?

22 A. No.

23 Q. Are you aware of any SEC commissioners who have reviewed
24 single-firm inspection reports in connection with the
25 appointment of board members?

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1 A. Yes, I doubt it. I can't imagine.

2 Q. Do you have an opinion on whether that single-firm
3 inspection report would be important in that respect?

4 A. In respect to appointment of --

5 Q. Appointment of board members.

6 A. No. No, I mean, it's --

7 Q. No, you have an opinion, or no?

8 A. I'm sorry. I don't think it would be important because it
9 doesn't deal with individuals. Really, it's a general report
10 about a firm.

11 Q. OK. And the SEC also approves the PCAOB rules, is that
12 correct?

13 A. Yes. All the rules have to go to the SEC for approval.

14 Q. Do you have an opinion on whether a single firm's
15 inspection report would be important in the SEC's consideration
16 of PCAOB rules?

17 A. No.

18 Q. Why is that?

19 A. Because, again, the inspection reports are very general,
20 very conclusory, very high level. And I mean, just, again, it
21 is only one firm, it's not -- it wouldn't really -- the rule is
22 much broader than one firm and is subject to notice and
23 comment. I mean, the PCAOB puts it out for -- to get public
24 comment. So with respect to rule, and then the SEC looks at
25 those comments as well. So there is a long process with

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1 respect to rules, and it is meant to get input from all sorts
2 of affected people.

3 Q. Are you aware, Mr. Atkins, that some portion of the Office
4 of Chief Accountant plays a role in reviewing PCAOB inspection
5 reports?

6 A. Oh, sure.

7 Q. And can you describe your understanding of the focus of the
8 Office of Chief Accountant's review of those inspection
9 reports?

10 MS. KRAMER: Objection, your Honor.

11 Q. Can you describe your understanding, if you have one?

12 MS. KRAMER: Objection, your Honor. Vague as to time
13 period and also foundation.

14 MR. BRUCH: Since the PCAOB was created.

15 THE COURT: Overruled. You can answer.

16 A. Well, yes. I mean, so the Office of Chief Accountant is
17 concerned about, you know, trends I guess in the profession
18 and, you know, concerned about audit quality and to try to make
19 sure that is, you know, maintained at a good level. But
20 mainly, you know, we're concerned about investor protection and
21 to try to avoid what's called a restatement, which is basically
22 an audit failure. So those are not really covered by
23 inspection reports. So, in general, this is one way to kind of
24 see what's going on in the audit profession.

25 Q. So are you familiar with the Division of Enforcement?

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Atkins - direct

1 A. Yes.

2 Q. Of the SEC, I should be clear.

3 A. Yes.

4 Q. Do you know whether the Division of Enforcement of the SEC
5 since the PCAOB has been created has reviewed PCAOB single-firm
6 inspection reports?

7 MS. KRAMER: Your Honor, I am going to maintain the
8 objection to questions that call for what's happened internally
9 at the SEC since the time that this witness left the SEC.

10 THE COURT: If you could establish his understanding.

11 MR. BRUCH: Sure.

12 BY MR. BRUCH:

13 Q. Do you have an understanding, based upon your discussions
14 with participants in the securities regulatory industry and
15 based upon your reading and knowledge of the securities
16 regulatory industry, how the SEC enforcement staff functions?

17 A. As to whether they look at examination reports or
18 inspection reports?

19 Q. The specific question will go to whether they review
20 inspection reports.

21 A. Yes, I obviously keep up with what goes on at the
22 Commission, you know, with respect to enforcement and
23 examinations and through discussions with people and
24 interactions with my clientele and that sort of thing. And
25 then as far as --

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Atkins - direct

1 Q. Do you have an understanding generally of the sources of
2 investigative leads in beginning investigations for the
3 Division of Enforcement at the SEC?

4 A. Sure.

5 Q. In your time as Commissioner and since that time as you
6 have been President of Patomak Global Partners and worked in
7 this industry.

8 A. Yes. Well, it's basically put their antennae out to try to
9 pick up leads through like their 20-some-thousand
10 whistleblowing tips that come into the SEC per year. There are
11 newspaper reports. There's, you know, rumors and tips that
12 come in directly to the Enforcement Division. Self-reporting.
13 There are companies that, you know, have discovered things
14 going on and they have undertaken an internal investigation,
15 and then they come to the Commission and say, you know, look
16 what we've found here, this is bad stuff, and, you know, you
17 need to know about it. So there are a lot of different ways
18 for the Enforcement Division to pick up on things.

19 Q. Do you have any understanding of the importance of
20 timeliness in the enforcement practice at the SEC?

21 A. Yeah. I mean, the timing is crucial. I mean, you have a
22 statute of limitations, so called, where if, you know, it takes
23 so long and if it -- you know, if you don't bring a case within
24 the requisite time period, then, you know, the case can't be
25 brought. So the Enforcement Division, if they hear about

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Atkins - direct

1 something, they want to jump on it and try to bring the case so
2 that we have the markets that, of course, if it's information
3 that can move stock prices or whatnot, then you need to try and
4 get that, you know, addressed as quickly as possible.

5 Q. So we talked about the -- you said that the Commission --
6 and I think the time period as clarified by the government was
7 within the past five years -- has brought maybe a handful of
8 cases, I think you said less than five, against the major
9 public accounting firms every year?

10 A. Yeah, something like one a year or so.

11 Q. Can you characterize what the Commission's interest is in
12 bringing enforcement actions in public auditing -- I guess
13 public auditing participants?

14 A. Well, again, a lot of these have to do with foreign
15 affiliates, because you have to remember these big accounting
16 firms are like networks of clubs. It is like a club with every
17 country has its own rules and own way of choosing and
18 qualifying accountants. And the accounting firms, in order to
19 be able to audit big multinational companies, have to have
20 people scattered about the world. And so those -- you know,
21 the SEC brings cases then to try to -- if they see wrongdoing
22 or if there has been a problem with what we call a restatement
23 or a company has filed its annual report with the SEC that, you
24 know, in its balance sheet or income statement or whatnot, if
25 there be a mistake, then you have to go back and restate that

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Atkins - direct

1 to make it correct. And so oftentimes that's an indication of
2 an audit failure where either an auditor didn't do something
3 right as far as overseeing what the company did, the company
4 internally didn't do something right. So those are the real
5 major -- that's the real major focus of the SEC.

6 Q. Is it safe to say that the inspection reports are one way
7 that the PCAOB staff communicates with the Securities and
8 Exchange Commission?

9 MS. KRAMER: Objection to the leading, your Honor.

10 THE COURT: Sustained.

11 Q. Are there ways in which the PCAOB staff communicates with
12 the SEC that do not involve the inspection process?

13 A. Oh, sure. I mean, there is a -- well, there should be a
14 good healthy exchange of information, and they get together at
15 conferences. There are informal meetings. You know, I myself,
16 when I was a commissioner, went over to the peek-a-boo to talk
17 to them about, you know, what was going on to meet the staff
18 and board members. So, there should be a healthy exchanges.

19 THE COURT: I just want to clarify.

20 MS. KRAMER: Objection, your Honor. I think perhaps
21 my objection relates to the follow-up question your Honor was
22 going to ask.

23 THE COURT: I was just going to ask about the use of
24 the term "peek-a-boo."

25 MS. KRAMER: Yes. If we could have a sidebar on that,

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Atkins - direct

1 your Honor, or we would object to the term and any testimony
2 about it.

3 MR. BRUCH: I just want to ask the witness to clarify.

4 THE COURT: OK. Go ahead.

5 MS. KRAMER: Objection to that question, your Honor,
6 under 403.

7 BY MR. BRUCH:

8 Q. Could you clarify what you meant by "peek-a-boo"?

9 A. I'm sorry. So that's an endearment maybe inside the Public
10 Company Accounting Oversight Board because it doesn't --

11 MS. KRAMER: Objection.

12 THE COURT: Without going into any detail, let me just
13 confirm, "peek-a-boo" is just a reference to PCAOB?

14 THE WITNESS: Yes.

15 BY MR. BRUCH:

16 Q. It is not intended to be a pejorative reference, is it,
17 Mr. Atkins?

18 A. No.

19 Q. Do any of the PCAOB's interactions with the SEC staff or
20 commissioners, are there any restrictions on those
21 communications?

22 A. Certainly between the staff.

23 Q. The staff -- between board members, commissioners? Broad
24 question.

25 A. Not that I can think of. Not if it is maybe confidential

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Atkins - direct

1 information or something that I, you know, I think between the
2 two agencies or two entities there --

3 Q. Is there anything that prohibits the PCAOB board from
4 calling the SEC at any time for any reason?

5 A. Oh, no.

6 Q. It doesn't depend on the inspection process, correct?

7 A. No. There is a fluidity there and they have lunch
8 together --

9 Q. Anything that prohibits the SEC from contacting the PCAOB
10 at any time?

11 A. Not that I can think of.

12 Q. For any reason?

13 A. I can't imagine.

14 Q. It does not depend on the inspection report being
15 delivered, correct?

16 MS. KRAMER: Objection. Asked and answered.

17 THE COURT: Overruled.

18 A. No.

19 Q. Does the SEC interact directly with the auditing firms
20 themselves?

21 A. Sure. A lot. The auditing firm come to the SEC on a whole
22 host of issues normally having to do with their public company
23 clients and, you know, how to treat different issues,
24 especially novel issues, but there are lots of meetings between
25 the staff of the agency, especially corporation finance and the

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Atkins - direct

1 various accounting firms.

2 Q. Would you characterize most of these involvements as
3 involving auditing issues or accounting issues?

4 A. No. They would be mostly accounting issues at the SEC.

5 Q. Do any of the SEC interactions with the public accounting
6 profession mandate the involvement of the PCAOB? In other
7 words, can the SEC directly communicate with the auditing
8 profession?

9 A. Yes. I mean, they communicate all the time and that's --
10 should be an open dialogue. The SEC needs to hear directly
11 from the profession, you know, the issues that they're coming
12 up with. And I think the SEC's, you know, very welcoming, or
13 should be, the staff should be, as far as having people come
14 forth and tell them what's going on. I have an open door, you
15 know, as far as auditing firms coming to discuss things.

16 Q. None of that depends on the SEC waiting for an inspection
17 report for a single firm, correct?

18 A. No. I mean, the timeframe of these inspection reports is
19 so elongated, it's kind of old news by the --

20 Q. Do you have an understanding of how elongated the timeframe
21 is between the events being inspected and the receipt of the
22 report?

23 A. When you look at them, it's like a year and a half or more.
24 I mean, it's a long process of review, and a lot of it is
25 confidential to, you know, the PCAOB. So it, you know, takes a

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Atkins - cross

1 while.

2 Q. Would you say that if the information in the report --

3 MS. KRAMER: Objection to the leading, your Honor.

4 THE COURT: Sustained.

5 MR. BRUCH: I have no further questions for
6 Mr. Atkins.

7 THE COURT: OK. Cross.

8 MS. KRAMER: Yes, your Honor.

9 THE COURT: Ms. Kramer.

10 CROSS-EXAMINATION

11 BY MS. KRAMER:

12 Q. Good morning, Mr. Atkins.

13 A. Good morning.

14 Q. Or good afternoon, actually.

15 A. Yes.

16 Q. You gave some testimony about how you have kept apprised of
17 issues at the SEC since you left in mid-2008. Do you recall
18 giving that testimony?

19 A. A few minutes ago, yeah.

20 Q. And you testified that you followed SEC developments.

21 Those were publicly knowable developments, right?

22 A. Sure.

23 Q. What you've read in the paper?

24 A. Or what the agency comes out with through speeches and
25 enforcement actions and a whole host of proposals for rule

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Atkins - cross

1 making and things like that.

2 Q. Things that are discussed at conferences?

3 A. Yes, partly, sure.

4 Q. You left the SEC in August of 2008, is that correct?

5 A. Yes.

6 Q. And you didn't work there in 2009, right?

7 A. Right.

8 Q. 2010?

9 A. Right.

10 Q. You haven't gone back to the SEC since you left in 2008,
11 right?

12 A. No, I've been back. I mean, I go back for meetings and
13 parties, you know, departure parties and welcoming parties.

14 Q. Social events, right?

15 A. Right, but also during the transition I was there as well,
16 so talking about policy.

17 Q. When you were on President Trump's Transition Committee?

18 A. Yes.

19 Q. And you were there talking about policy for a meeting,
20 right?

21 A. Right.

22 Q. And you had clients that have led you to go advocate at the
23 SEC?

24 A. No, not a lobbyist or a --

25 Q. OK. But you have not been an employee of the SEC since you

J34dmid3

Atkins - cross

1 left in mid-2008, right?

2 A. Right.

3 Q. You weren't working at the SEC when -- in 2015, right?

4 A. Right?

5 Q. Or 2016.

6 A. Right.

7 Q. Or 2017?

8 A. Right.

9 Q. You didn't participate at meetings between the SEC and
10 people from KPMG, including David Middendorf, in 2015, right?

11 A. Right.

12 Q. Or 2016?

13 A. Right.

14 Q. You weren't a party to those communications?

15 A. Right.

16 Q. You testified a fair amount about your familiarity with the
17 Sarbanes-Oxley Act. Do you recall that?

18 A. Yes.

19 Q. OK. And the Sarbanes-Oxley Act mandates that the PCAOB
20 conduct inspections, correct?

21 A. Right.

22 Q. And that they make reports of those inspections, correct?

23 A. Yes.

24 Q. And that they transmit those inspections to the SEC,
25 correct, and otherwise report wrongdoing that they discover to

J34dmid3

Atkins - cross

1 the SEC, right?

2 A. Right.

3 Q. And that reporting can happen before inspection reports are
4 ready, correct?

5 A. Absolutely.

6 Q. It can happen by phone during the inspection process,
7 right?

8 A. Right.

9 Q. And the Sarbanes-Oxley Act doesn't specifically speak to
10 what the SEC does once it gets the reports, right?

11 A. Right. Absolutely.

12 (Continued on next page)

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Atkins - cross

1 BY MS. KRAMER:

2 Q. That SEC has internal procedures to deal with reports that
3 are not laid out in the Sarbanes-Oxley Act, right?

4 A. Yes.

5 Q. And, the internal functioning of the SEC has changed over
6 time, right?

7 A. Probably. Sure.

8 Q. Well, even within your tenure as a commissioner there were
9 differences from year to year, right?

10 A. Yes.

11 Q. Different priorities?

12 A. Sure. Yes.

13 Q. Things changed within a given division when a division head
14 took over?

15 A. Right.

16 Q. The organization evolved internally, right?

17 A. Yes.

18 Q. As it has to because times and circumstances changed,
19 right?

20 A. Yes.

21 Q. And you testified a fair amount about when you were
22 commissioner whether you personally reviewed the inspection
23 reports for individual auditors.

24 Do you remember giving that testimony?

25 A. Yes.

J345mid4a

Atkins - cross

1 Q. And you talked about how you didn't review those reports,
2 right?

3 A. Yes.

4 Q. Approving the PCAOB budget or approving PCAOB board
5 members, right?

6 A. Right.

7 Q. When you were a commissioner, the Office of the Chief
8 Accountant was in place then true as it is now, right?

9 A. Yes.

10 Q. And the Office of the Chief Accountant is led by the chief
11 accountant for the SEC, right? And that person is the
12 commission's principal advisor on accounting matters, right?

13 A. On financial accounting matters.

14 Q. And on PCAOB-related matters, right?

15 A. I would think so, yes.

16 Q. And when you were a commissioner, did you actually
17 participate in decision-making about PCAOB board members,
18 whether they should be approved or not approved?

19 A. Yes.

20 Q. And when you did that, the chief accountant advised you;
21 isn't that right?

22 A. He played a role but I had my nominees that I advocated for
23 for particular spots so it is a give and take among the
24 commissioners to, you know, figure out what's the best person
25 to have there.

J345mid4a

Atkins - cross

1 Q. Mr. Urbanczyk, can we put up what is in evidence
2 Defendant's Exhibit M-305.

3 So, this is the organizational chart that you
4 testified about and so you were one of the five boxes at the
5 top, right?

6 A. Yes.

7 Q. So when you were making decisions, like approving PCAOB
8 board members, there were a lot of people below the level of
9 commissioner who prepared materials to aid in your review for
10 decisions like that, right?

11 A. Sure, but in that case it was mostly probably the general
12 counsel that had the main focus on an appointment like that.

13 Q. On your nominees?

14 A. Well, in the commission's -- how we were considering the
15 people to go on to the board of the PCAOB.

16 Q. You principally relied on the general counsel. Is that
17 what you are saying?

18 A. No. The general counsel was the one that had the primary
19 role of vetting people and summarizing their background. That
20 sort of thing.

21 Q. And the person in the general counsel's office reached out
22 to other divisions and offices within the SEC to gather
23 information, right?

24 A. Sure.

25 Q. That's the typical process, right?

J345mid4a

Atkins - cross

1 A. Right.

2 Q. And, as a commissioner who gets the end product of all that
3 vetting, a memo or some other document, is that the kind of
4 thing you would get at the end of that type of vetting process?

5 A. Yes; that there would be like an audit trail, if you want
6 to call it that, as far as like enforcement has no, nothing
7 that they found or whatever.

8 Q. So you get sort of memos from each division or office and
9 then sometimes some back up materials, right?

10 A. Right.

11 Q. You weren't privy to what every single person preparing
12 that briefing material reviewed in doing it, were you?

13 A. No. Of course not. But I mean, if there would be some
14 objection, they would presumably have that specified.

15 Q. That would sort of defeat the purpose of giving you
16 something succinct to review, right?

17 A. Right.

18 Q. And you testified, I believe, that the SEC oversight of the
19 PCAOB is mainly through the Office of the Chief Accountant.

20 Do you remember saying that?

21 A. Yes.

22 Q. And you didn't work, am I correct, in the Office of the
23 Chief Accountant when you were at the SEC?

24 A. No, because --

25 Q. So, before you were a commissioner you were a chief of

J345mid4a

Atkins - cross

1 staff to a commissioner, right?

2 A. For the chairman.

3 Q. For the chairman.

4 You didn't work in one of these smaller boxes under
5 that top row, right?

6 A. No, but I had -- I mainly had a lot of interaction with it,
7 yes.

8 Q. You had a lot of interaction when you were the chief of
9 staff for the chairman?

10 A. Yes.

11 Q. And that was before the Sarbanes-Oxley Act was enacted by
12 Congress, right?

13 A. Yes.

14 Q. And just looking at M 305, defendant's exhibit on the
15 screen, Mr. Urbanczyk, could you just circle for me as I go
16 through, you are aware, are you not, Mr. Atkins, that PCAOB
17 inspection reports arrive at the SEC through the office of the
18 secretary? That's in the second row on the right in the
19 middle. Right?

20 A. Yes. Down there, yes.

21 Q. And then the office of the secretary sends the reports to
22 different places in the SEC, right?

23 A. Yes.

24 Q. They go to the Office of the Chief Accountant?

25 A. Right.

J345mid4a

Atkins - cross

1 Q. And they also go to other divisions, right, when they come
2 in?

3 A. Right.

4 Q. Division of Enforcement?

5 A. Sure.

6 Q. The Division of Corporation Finance?

7 A. Right.

8 Q. Do they also go to Investment Management when they come in?

9 A. Probably. I mean, I don't know offhand.

10 Q. Within the Office of the Chief Accountant there are two
11 different groups that dive into the reports, right?

12 A. Right.

13 Q. There is the accounting group? Yes?

14 A. Yes.

15 Q. And the professional practice group?

16 A. Right.

17 Q. And they both look at the reports for slightly different
18 things, right?

19 A. Right.

20 Q. And then once they do that review, separate from the
21 reports having already gone to other divisions, the people in
22 the Office of the Chief Accountant can make referrals from
23 those inspection reports to any of these highlighted boxes on
24 the top or in the second row, right?

25 A. Right.

J345mid4a

Atkins - cross

1 Q. Plus, also, maybe I left out trading and markets but they
2 made referrals to these other offices, right?

3 A. Sure. I can imagine.

4 Q. And you talked a little bit about how, I think you might
5 have said that inspection reports, by the time they come in,
6 are old news?

7 A. Yes.

8 Q. Do you remember saying that?

9 A. Yes.

10 Q. And so, is it your opinion then, that this path that we
11 just talked about, all these offices and divisions at the SEC
12 reviewing the reports are just reading them for nothing?

13 A. No. I would never say that.

14 Q. They're not wasting their time, right?

15 A. Well, but anything that comes in, us know, there is
16 somebody that needs to look at it but I do not know of anything
17 like that that has led to, say, an enforcement action from an
18 inspection report.

19 Q. Let's talk about that for one second.

20 Enforcement actions are basically lawsuits, right?

21 A. Yes.

22 Q. They're publicly filed, right?

23 A. Yes.

24 Q. In courts, right?

25 A. Mostly I would think so.

J345mid4a

Atkins - cross

1 Q. And so, they're publicly knowable events, right?

2 A. Yes.

3 Q. When the SEC has an investigation -- let's make it easy and
4 say within the Division of Enforcement the SEC has an
5 investigation. Are you with me?

6 A. Yes.

7 Q. There is no report of the opening of an SEC investigation
8 generally, right?

9 A. Right.

10 Q. That's confidential, right?

11 A. Should be. Sometimes it's not, but.

12 Q. If it works the way it should it is confidential, right?

13 A. Yeah.

14 Q. If you are in the Division of Enforcement and you are
15 investigating someone you generally don't want them to know
16 you're investigating them, right?

17 A. Right, until --

18 Q. Or if they know there are reasons you don't make it public,
19 right?

20 And investigations don't always result in charges,
21 right?

22 A. Right.

23 Q. A lot of investigations, in fact, don't result in charges,
24 right?

25 A. That's true; because it doesn't rise to the level where the

J345mid4a

Atkins - cross

1 Agency wants to bring a case.

2 Q. So, there are different things that could happen that stop
3 an investigation from becoming an actual public case, right?

4 A. Right.

5 Q. There could be not enough evidence, right?

6 A. Right.

7 Q. There could be, in perhaps the view of the people
8 investigating enough but then the Commission says "no" for some
9 reason, right?

10 A. Sure. Policy, prosecutorial discretion. All of that.

11 Q. And then sometimes isn't it true that investigations end
12 with a settlement of some kind before there are actual charges,
13 right?

14 A. Right. Yes.

15 Q. So, putting aside clients that you have had that we have
16 told you they have an investigation, right, or sort of people
17 giving you those pieces of information, since you have left the
18 SEC in 2008 you haven't been privy to their roster of
19 investigations, right?

20 A. No. That's right.

21 Q. That would be highly unusual, right?

22 A. Right.

23 Q. You know what's been publicly filed as an actual case,
24 right?

25 THE COURT: I didn't hear an answer.

J345mid4a

Atkins - cross

1 THE WITNESS: Yes.

2 THE COURT: Okay.

3 BY MS. KRAMER:

4 Q. One of the things that you talked about when you were
5 describing at the beginning the overall role that the SEC plays
6 is that the SEC decides appeals from organizations that report
7 to the SEC.

8 Do you remember talking a little bit about that?

9 A. Yes.

10 Q. That includes appeals from decisions made by the PCAOB,
11 doesn't it?

12 A. Yes.

13 Q. And those appeals are reviewed by the Commission. Isn't
14 that right?

15 A. Yes.

16 Q. And that's something that happened or happens on a yearly
17 basis, right?

18 A. Well --

19 Q. For the inspection reports they're issued each year, so an
20 appeal of that is made generally on report that is filed each
21 year?

22 A. Right, if they're being appealed.

23 Q. If there is an appeal.

24 That's is something the Commission does with
25 inspection reports, right?

J345mid4a

Atkins - cross

1 A. Yes, but -- yes.

2 Q. And, when you were a commissioner, you testified that you
3 didn't personally read the inspection reports for the Big Four
4 firms?

5 A. Right.

6 Q. Just to be clear in the number that we are talking about
7 because I want to make sure this is not confusing, so is it
8 true that there is one report for each of the Big Four
9 accounting firms in the U.S. issued each year?

10 A. Right.

11 Q. And then within that one report for, say KPMG is, are the
12 negative findings from the 50 or so inspections of individual
13 audits that were conducted, right?

14 A. Right; on a no-names basis, but.

15 Q. On a no-names basis.

16 But the SEC gets the code, right?

17 A. Right.

18 Q. So, the SEC can know exactly who each issuer is, right?

19 A. Right.

20 Q. To help the SEC do its job with the reports, right?

21 A. Right.

22 Q. And then the Part II of the report has the negative
23 findings of the firm like KPMG that aren't necessarily specific
24 to a given inspection, right?

25 A. Right.

J345mid4a

Atkins - cross

1 Q. So the themes that came out of inspections, right, you have
2 a lot of problems in this particular area, right?

3 A. Right.

4 Q. And then also general concepts, like tone at the top,
5 right?

6 A. Yes.

7 Q. So, to adjudicate those appeals the SEC gets the inspection
8 report, right?

9 A. Right.

10 Q. The commissioners have to, who are working on the appeal
11 have to read the inspection report, at least the part that is
12 being appealed, right?

13 A. Well, in theory. I don't know of any appeal that's ever
14 happened, but yes.

15 Q. You didn't deal with an appeal by the time you left in
16 2008, right?

17 A. That's right.

18 Q. And that was 11 years ago?

19 A. Right.

20 Q. And this appeal process isn't a matter of public report
21 typically, right?

22 A. Right.

23 Q. So, let's just talk for one second about that Part II theme
24 that comes up sometimes, tone at the top.

25 You are familiar with that phrase, right?

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Atkins - cross

1 A. Yes.

2 Q. And it generally means, does it not, the leadership -- the
3 leadership's view -- withdrawn.

4 Generally it means the leadership of a firm's view or
5 tolerance of bad conduct. Is that a fair description of it?

6 A. Yes. The upper echelon should set a proper tone.

7 Q. And the tone at the top matters, right?

8 A. For most organizations I would think so, yeah.

9 Q. And you have written about that, have you not?

10 A. Yes.

11 Q. And tone at the top, in the context of a public accounting
12 firm has a lot to do, does it not, with auditor integrity?

13 A. Absolutely.

14 Q. And you agree, don't you, that it's important for the
15 auditing profession to have integrity, right?

16 A. Yes.

17 Q. To be effective?

18 A. Yes.

19 Q. Because auditors are gatekeepers of sorts, right?

20 A. Right.

21 Q. And they're first line of defense that investors have
22 against people who lie, cheat, and steal; right?

23 A. That's -- they, lawyers and others, right, need to act
24 accordingly.

25 Q. But auditors, public auditors are the first line of defense

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Atkins - cross

1 that investors have, right?

2 A. Actually, the first line of defense is ethics at the
3 corporation public company because they're the ones putting
4 together the financial statements and the auditors, of course,
5 are the ones to come in thereafter and give a report to the
6 board and shareholders as to the, that the statements are
7 produced in accordance with Generally Accepted Accounting
8 Principles.

9 Q. Do you recall participating in a lecture or giving a
10 lecture at Fordham Law School in 2008?

11 A. Sure. Yes.

12 Q. On the subject of corporate securities and financial law?

13 A. Yes. Probably.

14 Q. And you don't say things when you will give lectures that
15 are not true, right?

16 A. I hope not. Right.

17 Q. Didn't you say in this lecture in 2008: *We want to ensure*
18 *that there is a robust and effective auditing profession. Of*
19 *course that is the first line of defense that investors have*
20 *against people who would lie, cheat, and steal. So, we*
21 *definitely need to concentrate on that.*

22 Do you remember saying that in that speech?

23 A. I don't remember it but I-

24 Q. It has been awhile?

25 A. -- but I would agree with it.

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Atkins - cross

1 Q. You testified on direct examination at the beginning of
2 your testimony that the SEC rates auditors, right?

3 A. Well, the audit firms, as far as their adherence to the
4 standards that are laid out.

5 Q. So, I think you used the word "delegated" when you were
6 testifying earlier. Do you remember that?

7 A. Maybe. I don't have that.

8 Q. Well, the PCAOB is in charge of the inspection process,
9 right?

10 A. Yes.

11 Q. And then they have to send those reports to the SEC, right?

12 A. Yes.

13 Q. They can't just keep them to themselves, they have to send
14 them to the SEC, right?

15 A. Right.

16 Q. But the SEC also continues to regulate auditors of public
17 companies, right?

18 A. Well, again, I mean in the first instance it is the states,
19 of course, that, the individuals, but with respect to the firms
20 if the -- if there is an audit failure or what not, if the
21 accounting firm hasn't audited in accordance with respect to
22 GAAP principles and if there has to be a restatement that
23 affects the public company, then that's how the SEC steps in
24 for the most part and if there are ethics issues or something
25 like that with respect to an accountant practicing before the

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Atkins - cross

1 SEC, the SEC also has its own rules in that record.

2 Q. So, yes, then the SEC, the SEC regulates auditors, right?

3 A. Right. Yes.

4 Q. And, you mentioned the ethics and professional standards,
5 you are talking about SEC Rule 102?

6 A. Yes.

7 Q. So, the SEC can bring actions against individuals who fail
8 to follow professional standards or act with integrity, right?

9 A. Yes. It's a civil process, right.

10 Q. And that's another way that the SEC regulates accountants
11 and auditors, right?

12 A. Right. The practice before it. Right.

13 Q. Right; of public companies?

14 A. Yes.

15 Q. So, someone who is an accountant who is not working on a
16 public company, put those aside?

17 A. Right.

18 Q. The accountants and the audit firms that regulate -- that
19 audit public companies are regulated by the SEC including by
20 Rule 1-02(e), right?

21 A. Yes. Yes.

22 Q. Going back for just one second to the time that you were at
23 the SEC as a commissioner, I asked you some questions about how
24 the process went for your approval of PCAOB board members,
25 right?

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Atkins - cross

1 A. Right.

2 Q. I want to turn to just a couple of other ways that the SEC
3 interacted with the PCAOB.

4 So, with respect to the budget you talked a little bit
5 about how you had a hearing when you were a commissioner to ask
6 the PCAOB some pointed questions about its budget.

7 Do you remember that?

8 A. Yes.

9 Q. You have not, in your work since leaving the SEC,
10 participated in any cases or assignments that have had to do
11 with the SEC's approval of PCAOB's budget, right?

12 A. No. I have talked to commissioners about it but, no, I
13 haven't personally been involved with it.

14 Q. And since you left the SEC you don't know what the chief
15 accountant at the SEC considers in evaluating the PCAOB's
16 budget, right?

17 A. Not. Right, not in detail, no.

18 Q. You haven't had any conversations with the chief accountant
19 about what he considers in evaluating the PCAOB's budget,
20 right?

21 A. Well, I mean -- well, not specifically, right. In general,
22 I have talked to former chief accountants about the budget in
23 chief and about how PCAOB has operated.

24 Q. Generally, but not specifically, about what they consider
25 in evaluating the PCAOB's budgets, right?

J345mid4a

Atkins - cross

1 A. Right.

2 Q. Or what they have their staff do, right?

3 A. Right.

4 Q. Similarly you don't know exactly what the Chief Accountant
5 at the SEC does internally within the Office of the Chief
6 Accountant to tell his staff how to deal with the referrals
7 from reports that come in, right?

8 A. Sorry. Referrals from the report? The audit?

9 Q. So, when the chief accountant's staff is reviewing the
10 PCAOB inspection reports to make referrals there is a process
11 that's involved there, right?

12 A. Yes.

13 Q. And there are conversations that happen between the chief
14 accountant and the staff about what should and shouldn't be
15 referred, right?

16 A. Right.

17 Q. And you have not been personally involved in any of that
18 process, right?

19 A. Right, not. Yes.

20 Q. You are aware, aren't you, that some of what the SEC has
21 done in terms of using and looking at PCAOB inspection reports
22 changed in 2009, right?

23 A. Sure. I'm sure it changes a lot, like you were saying.

24 Q. But after the financial crisis and the collapse of Lehman
25 there was a change within the SEC in terms of how --

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Atkins - cross

1 MR. WEDDLE: Objection, your Honor.

2 MS. KRAMER: I'm sorry. What was the basis of the
3 objection?

4 MR. WEDDLE: Objection to discussion about Rule 403
5 with respect to the prosecutor's immediately expressed
6 question, your Honor.

7 THE COURT: Sustained.

8 MS. KRAMER: Your Honor, I believe that the witness
9 testified about this on direct examination. I can find the
10 place in the transcript but there was overt testimony about
11 that.

12 THE COURT: I think that was different.

13 MS. KRAMER: Okay.

14 THE COURT: I sustain the objection.

15 MS. KRAMER: Certainly, your Honor.

16 BY MS. KRAMER:

17 Q. So you are aware generally, Mr. Atkins, that things that
18 happen in the marketplace affect the way the SEC does things,
19 right?

20 A. Yes.

21 Q. When there is a need for more regulation the SEC often
22 implements more regulation, right?

23 A. Well, if it has authority and jurisdiction. Sometimes when
24 it tries it fails, like with hedge funds before Dodd-Frank and
25 that sort of thing.

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Atkins - cross

1 Q. When it has the authority, for instance under
2 Sarbanes-Oxley, and it sees a need to implement more regulation
3 to fulfill its mission it does that, right?

4 A. Well, it has to go through a notice and comment period and
5 it has to make a lot of decisions along the way but, yeah,
6 especially in the wake of Dodd-Frank and the financial crisis.
7 I mean, Dodd-Frank gave the SEC a lot more authority with
8 respect to regulation.

9 Q. And, so putting aside the comment period for rule making,
10 just in terms of enforcement within the SEC's already
11 established authority when there is a particular need to
12 address a problem, the SEC responds and tries to address that
13 problem, right?

14 MR. WEDDLE: Objection.

15 THE COURT: Overruled.

16 THE WITNESS: I think I -- yeah, it depends. I mean,
17 again, based upon authority and whatever the rules are but,
18 yeah, it might focus more attention on particular issues than
19 on others that it might not have looked at before.

20 BY MS. KRAMER:

21 Q. So, when it has the authority and there is a need to
22 address an issue the SEC focuses on that issue, right?

23 A. Yes.

24 Q. I want to just go back to something you said at the
25 beginning of your testimony and then I will wrap up, your

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Atkins - cross

1 Honor. I see it is almost 1:00 but I will be done before the
2 lunch break.

3 You testified early in your testimony that you are
4 getting paid -- your hourly rate is, I think you said, \$1,450,
5 right?

6 A. Right.

7 Q. So, that's \$1,450 an hour, right?

8 A. Right.

9 Q. And you are not the only person from your firm who has
10 worked on this case, right?

11 A. Right.

12 Q. Has Walton Liles also worked on this case?

13 A. Yeah.

14 Q. And he bills \$850 an hour?

15 A. I don't know, but if you say so. I don't know how much it
16 is.

17 Q. That sounds right, doesn't it?

18 A. Somewhere around there.

19 Q. And Randall Wilson, he also has worked on this case?

20 A. Yes. Probably.

21 Q. And Harrison Procter?

22 A. I guess so, yes.

23 Q. And they also bill in the hundreds of dollars an hour,
24 right?

25 A. Probably.

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Atkins - cross

1 Q. How much has your firm collected in exchange for your
2 testimony here at this trial?

3 A. I have no clue.

4 Q. You haven't sent out any bills yet?

5 A. Maybe we have. I don't know what that would be.

6 Q. Well, thousands of dollars, right?

7 A. Probably.

8 Q. Multiple bills that you have sent out since you started
9 working on this case?

10 A. I don't know.

11 Q. So much that you have lost track?

12 A. No, I -- that's handled by other people so, within my firm,
13 so I haven't seen the bills.

14 MS. KRAMER: May I have a moment, your Honor?

15 THE COURT: Yes.

16 MS. KRAMER: Nothing else, your Honor.

17 THE COURT: All right.

18 Is there anything further?

19 MR. WEDDLE: I have a line of questioning, your Honor.

20 THE COURT: Do you think we should break for lunch or
21 do you think it is going to be relatively short.

22 MR. WEDDLE: Mine is less than three minutes.

23 THE COURT: Okay.

24 CROSS EXAMINATION

25 BY MR. WEDDLE:

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Atkins - redirect

1 Q. Good afternoon, sir. My name is Justin Weddle, I represent
2 Jeffrey Wada in this case.

3 On cross-examination you were talking about tone at
4 the top and a speech that you may have given at Fordham Law
5 School. Do you remember that?

6 A. Yes.

7 Q. Is it your understanding that each and every deficiency in
8 tone at the top should be punished by the criminal law?

9 MS. MERMELSTEIN: Objection, your Honor.

10 THE COURT: Sustained.

11 BY MR. WEDDLE:

12 Q. Is it your understanding that each and every lapse in
13 auditor integrity should be pushed as a crime.

14 MS. KRAMER: Objection to this line of questioning,
15 your Honor.

16 THE COURT: Sustained.

17 MR. WEDDLE: Nothing further.

18 THE COURT: Mr. Bruch.

19 REDIRECT EXAMINATION

20 BY MR. BRUCH:

21 Q. Very quickly.

22 The prosecution asked a few questions about the SEC's
23 regulation of auditors. Has the SEC ever required auditors to
24 register?

25 A. Auditors to register?

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1 Q. Register with the SEC.

2 A. Not that I know of.

3 Q. Has the SEC ever conducted inspections of auditors?

4 A. No.

5 Q. Has the SEC ever required auditors to file periodic reports
6 or anything with the SEC?

7 A. No. That's not their role.

8 Q. Now, the government asked you about Rule 1-02(e) of the
9 Commission's practice and suggested it was a regulatory
10 measure. What is the purpose of Rule 1-02(e)?

11 A. Well, it's the rule of professional conduct with respect to
12 the SEC itself as to with lawyers and other professionals like
13 accountants. So, it is a discretionary rule by the SEC.

14 Q. Is it the rule that permits --

15 MS. KRAMER: Objection to the testifying and leading,
16 your Honor.

17 THE COURT: Sustained.

18 MR. BRUCH: No further questions.

19 THE COURT: All right. Ladies and gentlemen, we are
20 going to break for lunch.

21 You can step down.

22 (Witness excused)

23 THE COURT: Ladies and gentlemen, we will take an hour
24 for lunch. It is just about 1:00 and we will start back at
25 2:00. Please leave your note pads on your chairs. Have a good

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1 lunch. We will see you at 2:00.

2 (Continued on next page)

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(Jury not present)

THE COURT: You may be seated.

Anything anybody wanted to address before lunch?

MR. WEDDLE: Your Honor, we have one housekeeping matter.

MR. COOK: Your Honor, we would ask for oral permission -- we haven't drafted an order to this effect -- to allow some technical experts to come in and test the courtroom for a screen to be used during summation.

THE COURT: Okay.

MR. COOK: If that would be permissible.

THE COURT: Okay.

MR. COOK: And the microphone, a wireless microphone.

THE COURT: So you want a wireless microphone?

MR. COOK: Using the existing system, whether we can use a separate wireless mic so we can move between the screen and podium during summation.

THE COURT: Okay. I guess that's okay. Usually I don't like wandering summation where it's kind of like the Maury Povich Show, but you can use the wireless mic if it helps and it is fine if you are going to have a screen to go and point to something on the screen and go back to the podium. So, I don't have a problem with that.

MR. COOK: Thank you.

MS. MERMELSTEIN: Just in terms of the plan for the

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1 rest of the day.

2 I understand Mr. Lundelius is testifying next, we
3 don't have any sense of whether or not there are any witnesses
4 after that and we have not pushed the issue of whether or not
5 the defendants are testifying, recognizing that that often is a
6 late-time decision but I think we would like it know if they're
7 testifying and, if not, I think your Honor should allocute them
8 on the fact that that was their decision.

9 MR. BOXER: I didn't hear the last bit.

10 THE COURT: She asked me to allocute the defendants on
11 whether that was their decision if in fact a decision has been
12 made not to testify.

13 MR. BOXER: We will decide after Mr. Lundelius'
14 testimony if an allocution of some sort is necessary.

15 THE COURT: So, Mr. Lundelius is next?

16 MR. BOXER: He is next, yes.

17 THE COURT: Aside from defendants, is there any other
18 witness?

19 MR. BOXER: We have a summary chart witness as well,
20 your Honor.

21 THE COURT: All right.

22 Anyone else.

23 MR. COOK: We will have some, in addition to the
24 possibility of Mr. Wada testifying which we are still
25 evaluating, we have some stipulations to read into the record.

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1 THE COURT: Okay.

2 MR. WEDDLE: We may have one custodial witness from
3 Verizon, your Honor.

4 THE COURT: All right.

5 Okay. We will be in recess until 2:00.

6 (Luncheon recess)

7 (Continued on next page)

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A F T E R N O O N S E S S I O N

2:10 p.m.

THE COURT: Good afternoon.

Next is the testimony by.

MS. LESTER: Mr. Charles Lundelius, your Honor, our expert.

THE COURT: Anything you all need to address before that?

MS. KRAMER: Two very brief scheduling issues, your Honor.

First, while we were in court this morning, counsel for both defendants filed written objections that are together quite lengthy to the Court's proposed charge. We have obviously been here on trial and would like an opportunity to look at them and digest them and respond to them before the charge conference. So, I don't know in light of that that we are in position to be ready for the charge conference right when we stop today. So, we wanted to raise that. We can see where we are at the end of the day and talk about what makes sense but we wanted to put that on your radar.

THE COURT: Yes.

MS. KRAMER: Second, we understand that counsel for Defendant Wada is potentially going to call a witness from Verizon to offer some phone records. We will then have a small rebuttal case that we will need to put on. There is a witness

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1 who, you will recall, it was not out-of-state or anything, but
2 because it is unclear right now how much more there is on the
3 defense case and it sounds like it won't be clear until after
4 the next witness testifies, we aren't having that person come
5 to court today because it seems like it could be today or could
6 be tomorrow depending on how things go.

7 So we wanted to put that on your radar.

8 THE COURT: So you are assuming we are going into
9 tomorrow with testimony?

10 MS. KRAMER: I don't know. I think if both witnesses
11 testify then, yes. And even if just Mr. Middendorf testifies,
12 then I think that is a strong possibility but I obviously have
13 no idea how long his direct would be so I don't know but just
14 trying to plan for the eventualities.

15 THE COURT: Anybody want to add anything?

16 MR. WEDDLE: Your Honor, just with respect to the
17 Verizon witness that I mentioned earlier we may, instead of
18 calling the witness, offer a Rule 902 certification which I
19 think covers this issue. Obviously you don't see Rule 902
20 certifications too frequently in criminal cases because if the
21 government is not permitted to offer them because of the
22 defense's confrontation clause rights but, as offered by the
23 defense there is no obstacle to use of a 902 certification
24 other than calling custodial witness. So, if we get that
25 signed we won't have to call a witness. If we don't get it

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1 signed or if there is some problem with the 902 certification
2 then we would have this custodial witness from Verizon. I
3 don't think we can have the custodial witness from Verizon here
4 today so if we needed to do that we would ask the Court's
5 permission to do that first thing in the morning, if that's
6 where we are in the trial.

7 THE COURT: All right.

8 MS. LESTER: Just one more thing, your Honor.

9 During the cross-examination of Mr. Sweet I offered
10 Defendant's Exhibit M-277, which was a photograph from a
11 website subject to authentication. The government has agreed
12 to stipulate to the authentication of that witness so I just
13 want to put that on the record, that it is now fully in
14 evidence.

15 MS. KRAMER: That's correct, your Honor.

16 THE COURT: M-277.

17 MS. LESTER: Yes, your Honor.

18 THE COURT: Just to be clear for the record, that's in
19 evidence.

20 (Defendant's Exhibit M-277 received in evidence)

21 MR. WEDDLE: And, with respect to Defendant Wada's
22 case, your Honor, this is an issue that we raised at some point
23 last week, which is that we intend to offer some excerpts of
24 chats and I propose that if there is a convenient time for the
25 Court, that we could go through and talk about the individual

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1 basis for the admission. They're all admissible not for their
2 truth. Some of them, also, I think would fall within the state
3 of mind exception to the hearsay rule but I don't know if your
4 Honor wants to do that at some point when we are not delaying
5 the jury or if you want to do that on the fly. We are happy to
6 do it either way.

7 THE COURT: Is the government going to be objecting to
8 those?

9 MS. ESTES: We are not objecting to authenticity.
10 There are a few where we have hearsay objections.

11 THE COURT: All right.

12 MS. KRAMER: Just to be clear, your Honor, on the 902
13 certification issue, we have not seen any certifications to
14 date, and have a right to inspect them and it is not clear that
15 we have seen the actual exhibit either. We understand that it
16 comes from data that was in that spreadsheet but that defense
17 counsel is operating on the information that some of the data
18 in that spreadsheet is Verizon.

19 We haven't seen the exhibit, we haven't seen the
20 certifications, and so I don't want our silence to be
21 misconstrued as consenting to that procedure because it is not
22 clear that we will.

23 MR. WEDDLE: To give a little bit more explanation,
24 your Honor, the government produced to the defense a number of
25 spreadsheets that they said in their cover letter were KPMG

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1 conference call data. We got a very large compilation
2 spreadsheet several weeks ago and then in the middle of trial I
3 think we got 30 or 40 a additional spreadsheets which, we were
4 told by the government, were produced to KPMG by KPMG's service
5 provider Verizon, and then produced to the government and
6 produced to us as conference call data.

7 There are three conference calls that we plan to admit
8 into evidence under Rule 902.13. The conference call data
9 itself is admissible, it is the result of a process that is
10 when conference calls are made, the computer system records
11 data about the conference call, it is not a human being who
12 records it. So, 902.13 is specifically intended to avoid
13 having to call custodial witnesses to authenticate things like
14 computer processes that accurately and automatically record
15 data regarding things that are taking place in the computer.

16 So, there isn't actually an exhibit. We have tried to
17 reach a stipulation with the government with respect to this,
18 with respect to one of the spread sheets that the government
19 produced to us. We were not successful in reaching the
20 stipulation. We don't need to admit the spreadsheet which has
21 thousands of lines in it, maybe tens of thousands of lines.
22 There is just three lines that we think are admissible and we
23 propose to put them directly into the 902.13 certification and
24 the certification would basically be by someone at Verizon who
25 says that Verizon provides conference call hosting services to

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1 KPMG, that when a conference call is hosted the computer system
2 records certain data including the call date and time and
3 duration as well as the call-in number that is the phone number
4 of the person who is entering the conference call. That data
5 is automatically recorded by the computer system and those
6 three lines of data we would just put directly into the 902.13
7 certification.

8 THE COURT: Okay. So the government is aware of what
9 those three lines are?

10 MS. KRAMER: We haven't see any certification, your
11 Honor.

12 We have had a lot of discussions that aren't worth
13 airing here about the nature of the evidence and it's accuracy.
14 So, once we see what the defense proposes to offer, we will
15 respond to them. Time is obviously running out in the trial
16 and so we just wanted to alert your Honor to that and if they,
17 whether they put it in through custodian or through one of
18 these certifications, we will have a rebuttal case.

19 So, once we have a better sense of timing, we will get
20 that witness here.

21 THE COURT: Okay. So, should we go ahead with
22 Lundelius for now and then see where we are after that, and
23 your summary witness.

24 MS. LESTER: That's fine with us, your Honor.

25 MR. BOXER: Yes.

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1 THE COURT: You can bring him in and we will get the
2 jury in.

3 (Continued on next page)
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Lundelius - direct

1 (Jury present)

2 THE COURT: Good afternoon, ladies and gentlemen.

3 THE JURY: Good afternoon, sir.

4 THE COURT: Welcome back. We are continuing with the
5 evidence in the case and Ms. Lester, you may call your next
6 witness.

7 MS. LESTER: Thank you, your Honor. The defense calls
8 Charles Lundelius.

9 THE COURT: Sir, if you would please raise your right
10 hand, Mr. Hampton will swear you in.

11 CHARLES REYNOLD LUNDELIUS, JR.,

12 called as a witness by the Defendants,

13 having been duly sworn, testified as follows:

14 THE DEPUTY CLERK: Please state your full name and
15 spell your last name, slowly, for the record.

16 THE WITNESS: Charles Reynold Lundelius, Jr.
17 L-U-N-D-E-L-I-U-S.

18 DIRECT EXAMINATION

19 BY MS. LESTER:

20 Q. Good afternoon, Mr. Lundelius.

21 A. Good afternoon.

22 Q. Where are you employed?

23 A. I'm employed at Berkeley Research Group in Washington, D.C.

24 Q. Is Berkeley Research Group also known as BRG?

25 A. Yes, it is.

J345mid4

Lundelius - direct

1 Q. And what type of organization is that?

2 A. It's a consulting firm. We have economists, accountants,
3 as well as specialists in other fields.

4 Q. How long have you worked at BRG?

5 A. About seven years.

6 Q. And, in your work there, what are your general duties and
7 responsibilities?

8 A. I run the capital markets group. That's a group of
9 individuals that deal with regulatory, as well as finance
10 issues. They specialize in accounting, as well as other areas.

11 Q. What did you do prior to working at BRG?

12 A. I was at another consulting firm for about 11 years.
13 Previous to that I was at both Coopers & Lybrand and Deloitte
14 at various points in time working in their audit groups or
15 their financial advisory group.

16 Q. What is your educational background?

17 A. I have a Bachelors of Science in Commerce from the
18 University of Virginia with a concentration in accounting, and
19 then I have a Masters in Business Administration from Tulane
20 University with a concentration in finance.

21 Q. Do you hold any certifications?

22 A. I do. I am a certified public accountant, I am accredited
23 in business evaluation business the American institute of CPAs,
24 and I am certified in financial forensics by the American
25 Institute of CPAs.

J345mid4

Lundelius - direct

1 Q. In the course of your career, have you had experience,
2 direct experience in auditing the financial statements of
3 financial institutions, in particular?

4 A. Yes, I have.

5 When I first started in public accounting that was in
6 1980. I started at what was one of the big 8 firms and was on
7 their financial institution's audit team.

8 Q. As a result of your work and training, do you have general
9 familiarity with auditing standards that apply to the work of
10 auditors?

11 A. That I do. Yes.

12 Q. And are you familiar with AS 3, for example?

13 A. Yes.

14 Q. And AU 390?

15 A. Yes.

16 Q. Have you written any articles or books relative to the
17 accounting field?

18 A. I have. I have published -- well, the American Institute
19 of CPAs has published two of my books. They deal with
20 financial reporting fraud they also deal with internal control
21 at firms.

22 Q. Have you ever testified previously in court?

23 A. Yes, I have.

24 Q. How many times, approximately?

25 A. Over 30.

J345mid4

Lundelius - direct

1 Q. Have you been retained by the defense group in this case?

2 A. Yes, I have.

3 Q. What is your hourly rate for your services?

4 A. Well BRG, my employer, charges \$950 an hour for my time.

5 Q. Is that your standard rate?

6 A. Yes, it is.

7 Q. In prior cases where you have testified, Mr. Lundelius,
8 have you reviewed audit workpapers in preparation for that
9 testimony?

10 A. That, I have. Yes.

11 Q. And, in preparation for your testimony in this case, did
12 you also review some audit workpapers?

13 A. Yes, I did.

14 Q. We will return to that in a moment. For now let's talk
15 about some general terms related to auditing.

16 Could you explain to the jury, generally, what is the
17 role of an auditor?

18 A. Well, an auditor is charged with certifying whether the
19 financial statements are fairly presented in accordance with
20 U.S. Generally Accepted Accounting Principles.

21 Q. How does the auditor do that?

22 A. The auditor does that by performing certain procedures.
23 Some include tests, some include inquiry, confirmation of
24 balances, various other activities and procedures to verify the
25 validity of the financial statements. The auditor will first

J345mid4

Lundelius - direct

1 start with looking at the general controls at a firm and then,
2 after testing those, they'll go and look at the actual balances
3 that show up on the income statement and the balance sheet.

4 Q. What is the work product, if any, that an auditor
5 generates?

6 A. At the end of the process an auditor generates, for a
7 public company like the ones that we are dealing with here, two
8 different opinions. One is an opinion on the financial
9 statements themselves, whether they're fairly presented, just
10 as I said, in accordance with generally accepted accounting
11 principles. The second opinion is an opinion that attests to
12 management's assertion, that is every company's management as
13 to determine whether or not their internal controls over
14 financial reporting are operating properly and the auditor
15 issues a second opinion on management's assertion.

16 Q. Do you have a general understanding, based on your own
17 experience at an audit firm, of what the role of the national
18 office of an audit firm is?

19 A. Yes.

20 The major accounting firms like KPMG all have a
21 national practice office. It's a group of individuals that are
22 specialists in accounting and auditing issues. They assist
23 the, what they call the line partners, the partners that are
24 out in the field actually running audits on companies, they
25 will sometimes need assistance in terms of accounting advice or

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Lundelius - direct

1 auditing advice and they can call on these individuals at the
2 national practice office and hopefully get that advice.

3 Q. So, is it fair to say that the members of the national
4 office are not the people on the ground who are actually
5 conducting the audits themselves?

6 A. Yes. That's correct. They are not.

7 Q. For the next set of questions let's assume that we are
8 talking about public companies and the audits of public
9 companies. Okay?

10 A. Okay.

11 Q. Assuming such a company operates on a fiscal year that's
12 the same as the regular calendar year, is there typical
13 timeline for the auditor's work on that company's financial
14 statements?

15 A. Yes. The auditor has to finish this process within a very
16 short period of time after the end of the year. It depends on
17 how large the audited entity is but that time frame is either
18 60 or 75 days to get the audit opinion deleted and a report
19 filed with the SEC. So, because of that tight time pressure
20 auditors begin their work before year-end trying to do as much
21 test work to get this out of the way so in that very narrow
22 window that they have after year-end they go back and finish up
23 their work.

24 Q. You mentioned a 60 or 75-day period after the end of the
25 fiscal or calendar year in our case. What is the significance

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Lundelius - direct

1 of that date 60 or 75 days later?

2 A. That is the date that is determined by the SEC for actually
3 filing a, in this case a form 10-K annual statement that goes
4 to the SEC and it then is published and it contains not only
5 your financial statements but a lot of disclosures that are
6 made by the company management as well.

7 (Continued on next page)

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Lundelius - direct

1 Q. And so that's a deadline for the company itself, not the
2 auditor?

3 A. That's correct, that's the deadline for the company itself.

4 Q. And does that date also have significance for the auditor?

5 A. Yes. The auditor has to finish his work and actually be in
6 a position to release his report at sometime before that so
7 that it gets incorporated into the SEC file.

8 Q. And by that point in time, what's the status of the audit
9 procedures?

10 A. At that point in time, the audit procedures are to finalize
11 the various procedures that are being done, the tests, the
12 confirmations. Everything that needs to be done that couldn't
13 be done before year end now has to be wrapped up in those first
14 couple months that follow after year end. And then there is a
15 process the auditor goes through to actually get ready to sign
16 off on the report, and hopefully that's done in a timely
17 fashion. And then the auditor also signs off on the opinion on
18 the internal control, and then that's all wrapped up into the
19 10-K filing.

20 Q. And is that sometimes referred to as the report release
21 date?

22 A. Right. The report release date is the date that the
23 auditor has actually said the report -- his report, the audit
24 firm's report, is ready now to be released.

25 Q. And at that point are audit procedures complete?

J34dmid5

Lundelius - direct

1 A. Audit procedures may continue. The audit rules allow for
2 the auditors to take 45 days after the report release date to
3 wrap up their documentation of the process. That wrap-up
4 period should include, or should involve completing the
5 documentation on work that was done and tests that were done
6 before that report release date.

7 Q. And that could include documenting work that had already
8 taken place but for which there was no documentation up to that
9 45-day period?

10 A. It could include that, or it could -- more often it
11 involves simply finishing the documentation it perhaps started
12 before the report release date.

13 Q. Is there an auditing standard that governs the
14 documentation period?

15 A. Yes, there is, and for our purposes that is that's AS 3.

16 MS. LESTER: I would like to put up what's already in
17 evidence as M176.

18 Q. Is this Auditing Standard Number 3, or AS 3, Mr. Lundelius?

19 A. Yes, it is.

20 MS. LESTER: We can take that down. Thank you.

21 Q. What happens if at some point after the report release date
22 an auditor realizes that additional work has to be done?

23 A. There is a procedure set up for that in the audit
24 standards. The issue is if the auditor felt like there was
25 some procedure that they omitted that they should have done

J34dmid5

Lundelius - direct

1 before the report release date but they didn't, so now they're
2 playing catch up and trying to get that done, they have --
3 during that 45-day window, they have a period of time in which
4 then can actually pursue the additional work and get it done,
5 and that's governed by a separate standard called AU 390.

6 MS. LESTER: If we could put up for the witness what's
7 been marked for identification as Defense Exhibit M186, please.

8 Q. Do you recognize this, Mr. Lundelius?

9 A. Yes. That is the consideration of omitted procedures after
10 the report date.

11 Q. And is that AU 390 to which you were just referring?

12 A. It was, yes.

13 MS. LESTER: Your Honor, we offer M186.

14 THE COURT: M186 is received in evidence.

15 (Defendant's Exhibit M186 received in evidence)

16 BY MS. LESTER:

17 Q. And so, Mr. Lundelius, you mentioned, I believe, that if
18 additional work is necessary during the 45-day documentation
19 period, this is the rule that applies or the standard that
20 applies. What about work that is discovered, for whatever
21 reason, after the 45-day period?

22 A. Well, if there is something that is discovered after that
23 period of time that needed to be done and it was -- it relates
24 to presumably something that's important, something that was
25 omitted that you now need to go back and test, you can actually

J34dmid5

Lundelius - direct

1 do that under the standards, but now you have -- you have to
2 document that as well and make it clear that -- the only
3 changes you can make to the audit documentation at this point
4 is to add more documentation to the file. You can't delete it
5 after the 45-day period ends.

6 Q. And so if you did additional work, would you use AU 390 to
7 document that work?

8 A. You do to the extent that it's needed, but you also have
9 another provision that comes into play if indeed you found new
10 facts and that's AU 561.

11 MS. LESTER: You can talk that down. Thank you,
12 Ms. O'Connor.

13 BY MS. LESTER:

14 Q. What happens at the end of the 45-day period?

15 A. At the end of the 45-day period, you actually are at the
16 documentation completion date, and so all documentation to that
17 point should be in the file. As I said, you could add to it
18 after that date but you cannot change or delete anything after
19 the documentation completion date.

20 Q. Has that 45-day deadline for documentation always existed?

21 A. No, it has not. It was implemented with AS 3.

22 Q. Do you know when, about, approximately, AS 3 was put in
23 this place?

24 A. I believe it was sometime around 2004/2005, in that
25 timeframe.

J34dmid5

Lundelius - direct

1 Q. And based on your experience, do audit firms nowadays keep
2 their workpapers in electronic or in hardcopy form?

3 A. Well, they keep it in electronic form mostly now.

4 Q. And so at the end of the 45-day period, what happens to the
5 electronic file?

6 A. The electronic file should be locked down in some form such
7 that changes made after that date are simply added to the file
8 and you can't delete.

9 Q. Mr. Lundelius, are you familiar with the term "allowance
10 for loan lease losses," or "ALLL"?

11 A. Yes.

12 Q. What does that mean?

13 A. Well, that is an allowance -- or the nonaccounting term is
14 a reserve, but it's a set aside for loans that may go bad or
15 some portion of loans that may go bad.

16 Q. And does that term apply only to institutions that make
17 loans of some sort?

18 A. It applies to, yes, an institution that makes loans, yes,
19 any entity that makes loans, correct.

20 Q. So it doesn't necessarily have to be a bank, it would just
21 have to be another financial service institution, for example,
22 that makes a loan?

23 A. That is correct, yes.

24 Q. The reserve or the allowance that you mentioned, does it
25 have more than one aspect to it?

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Lundelius - direct

1 A. It comes in two general forms. There is a general
2 liability -- general loan loss liability, and then there is a
3 specific loan loss liability. Those are typically the way
4 financial institutions handle it.

5 They'll put a pool of loans into the general liability
6 section and then figure out out of that pool what percentage,
7 roughly, will go bad at certain points in time; that will
8 determine general liability. Then the specific liability
9 relates to loans that have actually indicated or looked like
10 they are going bad, and they'll move them over into that
11 liability and start assessing a separate charge for credit loss
12 based off of that group.

13 Q. So do lending institutions keep track of those two sets of
14 reserves separately?

15 A. They do internally, that's right, though I think they
16 report them as combined.

17 Q. How do lending institutions go about determining what the
18 reserve or the allowance for loans that might go bad should be?

19 A. They look at a number of factors. The GAAP standard is
20 the -- GAAP is written very tightly. It has -- essentially
21 requires that it is probable that a certain loan has incurred a
22 loss. And "probable" is a very high standard for accountants.
23 Probable means likely to happen. And if you want to put a
24 percentage on it, accountants usually say it is like an
25 80 percent chance or more of having happened. So, it's a very

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Lundelius - direct

1 high bar.

2 And what the reserves are attempting to do is to see
3 how many loans have deteriorated to the point where they hit
4 that bar or go over it. And so what will happen is the -- say
5 the general liability reserve will look back in time and say,
6 well, you know, so many loans go bad out of this particular
7 type of group, say the commercial loans or residential loans,
8 and they'll run a percentage calculation off of that against
9 the loan balance, and they'll adjust it. There is a lot of
10 subjectivity here but they can adjust it, and then they report
11 out a general liability reserve.

12 Q. You mentioned the term "GAAP." Could you explain to the
13 jury what that is?

14 A. Generally Accepted Accounting Principles is GAAP. It is a
15 set of accounting rules that are set up by the Financial
16 Accounting Standards Board. The FASB is based up in Norwalk,
17 Connecticut. And they write these rules for U.S. issuers.

18 There's another rule standard setter that is in
19 Europe, and they write rules for international firms.

20 Q. Now, the exercise that you described just a moment ago of
21 estimating the amount of the allowance for the reserve, is that
22 something that is undertaken by the lending institution or by
23 the auditor?

24 A. The lending institution has to come forward and actually
25 make these estimates. The role of the auditor is to come in

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Lundelius - direct

1 and test the reasonableness of the estimates.

2 Q. How does the auditor do that?

3 A. The auditor does it with great difficulty. The process is,
4 as I said, subjective in many cases. If you look at, say --
5 well, for a given let's say a given liability -- general
6 liability reserve, you're trying to get a percentage number to
7 multiply against the total loan balance to tell people how many
8 loans or how much in dollar amount in loans will go bad. That
9 process has a quantitative aspect to it, very numbers-driven,
10 and then a qualitative aspect to it that's very squishy. It's
11 like -- the qualitative aspect is do we think business
12 conditions are going to get better or worse? Do we think our
13 loan officers are getting better at their jobs or worse at
14 their jobs? Really, really subjective.

15 The quantitative side is not free of subjectivity,
16 though it has got a lot of subjectivity. It says, well, let's
17 see. Where do we think a loan first started to go bad, because
18 that's going to impact our numbers? If it was a year ago, that
19 gives us one result. If we think the loan started to go bad
20 two years ago, then that gives us a completely different
21 result. So you're in there trying to get us -- or get to a
22 point where you can make a defensible argument, I should say,
23 that the loans started to go bad at, you know, 12 months, 18
24 months, 24 months before they actually did show up as a charge
25 off.

J34dmid5

Lundelius - direct

1 Q. And that exercise of judgment that you were just
2 describing, is that something that the lending institution
3 undertakes or the auditor?

4 A. Again, the lending institution is doing this. The auditor
5 comes along and tests these subjective judgments as best as the
6 auditor can. The auditor has a fairly daunting task, though.
7 The auditor is looking at these subjective measures and trying
8 to see how much support there is that management has for these
9 judgment calls that management is making. And the issue really
10 is is how much does the auditor have to document in order to
11 get some level of actually being able to convey to the
12 auditor's superiors that he has looked at a lot of this stuff
13 and really, really examined it and pulled it apart. There are
14 no clear standards for that. It's a judgment call as to how
15 subjective the reserving process is, and then it is another
16 judgment call as to how subjective the audit documentation
17 process is.

18 Q. Generally speaking, with respect to auditors' work, are
19 there many areas that involve a level of judgment?

20 A. Yes, there are. There are estimates of all sorts. We've
21 got a whole range of new accounting standards that involve
22 estimates. So this is certainly the case that you have a lot
23 of estimates. I find in this area where we are talking about,
24 loan loss, it's -- it's estimates upon estimates upon estimates
25 and it gets multilayered and it gets pretty complex pretty

J34dmid5

Lundelius - direct

1 quick.

2 Q. So how would you describe, for lack of a better term, the
3 degree of difficulty in terms of estimating the allowance for
4 loan lease losses compared to other types of auditor judgment
5 areas?

6 A. Yeah, I put it like at the top of the areas where it is
7 most difficult for an auditor to both assess as well as
8 document.

9 Q. At the beginning of your testimony, Mr. Lundelius, you
10 referenced the fact that you had reviewed workpapers in
11 preparation for your appearance here today.

12 Just generally speaking, what did you review?

13 A. I looked at a set of workpapers that were produced in this
14 matter. The workpapers included well fairly complete sets of
15 workpapers for about six different audit clients of KPMG that
16 are at issue here, and then I have some limited amount of
17 workpapers on some other KPMG clients.

18 Q. And in connection with your review, did you also review
19 email correspondence that related to those workpapers?

20 A. That I did, yes.

21 Q. And were you asked in particular to look at examples of
22 suggested changes to those workpapers?

23 A. Yes, I did.

24 Q. What types of suggested changes did you see, generally
25 speaking?

J34dmid5

Lundelius - direct

1 A. I saw changes that were -- I mean, they were important to
2 the documentation but they were fairly specific and fairly
3 minor in that they would either be requests to go and explain
4 something more, which is not at all surprising given the
5 subjectivity involved in loan losses, and then there were some
6 requests for it to summarize findings. Just simply, you would
7 have a list of findings and then the request would be, well,
8 please add a summary at the bottom. There were other requests
9 to do some fairly straightforward calculations of some findings
10 that had been presented earlier. That I think was the majority
11 of the changes that were requested.

12 Q. And the workpapers and email correspondence that you
13 reviewed, did you understand that to relate to specific audits
14 that had been subjected to a rereview during the 2016 period?

15 A. Yes. These were all changes -- I think in terms of the
16 emails that I saw, these were changes related to the rereview
17 that I was summarizing.

18 Q. And you understood that those workpapers related to the
19 charges in this case?

20 A. That's my understanding, yes.

21 Q. In your review of those workpapers, did you see any
22 documents that established a violation of any account auditing
23 standards?

24 A. No, I did not.

25 Q. And did you review any workpapers that reflected additional

J34dmid5

Lundelius - cross

1 audit procedures that were performed after the report release
2 date?

3 A. Yes, I did. I did in two instances.

4 Q. Do you remember what those were?

5 A. Yes. The specific issuer or -- one was AMBAC, the other
6 was FBFS.

7 Q. And was there any particular documentation prepared in
8 connection with those instances of additional work?

9 A. Yes. KPMG had a special form that they would use for AU
10 390 type of work. That is additional procedures done after the
11 report release date. So that form would be -- it's found in
12 both those files.

13 Q. And based on your review of that documentation, did the
14 work that you reviewed comply with the AU 390 standard?

15 A. Yes, it did.

16 MS. LESTER: May I have a moment, your Honor?

17 THE COURT: Yes.

18 (Pause)

19 MS. LESTER: No further questions.

20 THE COURT: OK. Ms. Estes.

21 CROSS-EXAMINATION

22 BY MS. ESTES:

23 Q. Good afternoon, Mr. Lundelius.

24 A. Good afternoon.

25 Q. So I just want to go back to your background a little bit

J34dmid5

Lundelius - cross

1 first.

2 I believe you testified on direct examination that you
3 currently work at a consulting firm, is that right?

4 A. That is correct, yes.

5 Q. And you testified that you also worked at Deloitte for a
6 little bit, is that right?

7 A. I did, yes.

8 Q. Was that in the 1908s?

9 A. No. That was in the late '90s.

10 Q. Late '90s.

11 And since you worked at Deloitte in the late '90s,
12 have you worked at any auditing firm?

13 A. No, I have not.

14 Q. And you've never worked at the PCAOB, right?

15 A. That's correct.

16 Q. You've never worked at the SEC, right?

17 A. I was retained by the SEC for various matters and including
18 one matter that involved when I was retained by the Inspector
19 General of the SEC to look into why the SEC failed to catch
20 Madoff. So if that counts as employment at the SEC, I've --

21 Q. You've never been employed by the SEC directly, right?

22 A. Well, I've worked under contract to them so I guess
23 that's -- my answer is no direct employment.

24 Q. Now, when you worked at -- you worked at Deloitte in the
25 1990's, right? That was before the PCAOB was in existence?

J34dmid5

Lundelius - cross

1 A. That's correct, yes.

2 Q. And you claim you are familiar with the PCAOB's auditing
3 standards through your current work, right?

4 A. That is correct, yes.

5 Q. You hadn't worked as an auditor since the PCAOB was formed,
6 right?

7 A. That is correct, yes.

8 Q. Not a day?

9 A. Not a day.

10 Q. And you testified extensively about AS 3, right?

11 A. I testified about AS 3, yes.

12 Q. That is a PCAOB standard?

13 A. Yes, it is.

14 Q. And it was promulgated I think you said in 2004, 2005?

15 A. That's correct, yes.

16 Q. So, again, that's after you were -- after your work as an
17 auditor ended, right?

18 A. That's correct, yes.

19 Q. So you've never personally applied AS 3 in an audit?

20 A. Well, I have applied AS 3 and looked at it with regard to
21 certain litigation engagements that I have been working on that
22 involve a review of audit workpapers. So, yes, I have applied
23 AS 3.

24 Q. So when you have been hired as an expert witness and been
25 paid for that you have applied AS 3, right?

J34dmid5

Lundelius - cross

1 A. Yes, right.

2 Q. OK. And I think you said you also had direct experience
3 auditing financial institutions, is that right?

4 A. Yes.

5 Q. So that was back in the 1980s, you said?

6 A. Yes. And then I was retained in -- I think it was around
7 2003 I was brought in to assist with the internal investigation
8 of Freddie Mac, and that was working closely with their
9 auditor, PriceWaterhouseCoopers.

10 Q. Again, that was as an expert witness, right?

11 A. That was part of the investigator team. There was no
12 expert witness work in that.

13 Q. You were paid for your work, right?

14 A. Yes.

15 Q. And you worked at a consulting firm at that point, right?

16 A. Correct, I did.

17 Q. And you worked at various consulting firms since the early
18 2000s, right?

19 A. Right.

20 Q. Primarily as an expert witness, right?

21 A. No. I'd say -- I've been involved in quite a few
22 investigations and I wouldn't say primarily.

23 Q. Now, you testified that for this case you're billing about
24 \$950 an hour, right?

25 A. That's correct, yes.

J34dmid5

Lundelius - cross

1 Q. And so about how much total do you expect to be paid?

2 A. Well, my firm -- I will get paid. I know it is in excess
3 of a hundred thousand dollars. I don't know what it is exactly
4 beyond that.

5 Q. You said over a hundred thousand dollars?

6 A. Yes, that is correct.

7 Q. And is that just for you or for others on the case, too?

8 A. That includes a team, a team of other CPAs that work with
9 me.

10 Q. Now, Mr. Lundelius, I am going to return to your work on
11 this case.

12 You reviewed certain documents in the case, right?

13 A. That I did, yes.

14 Q. Documents provided to you by the defense?

15 A. Yes.

16 Q. And some of those documents involve the allowance, right?

17 A. Yes.

18 Q. And you testified that you didn't see any work that was
19 done and not documented, right?

20 A. I don't recall a specific question on that. I said that --
21 I found additional work that was documented.

22 Q. Putting aside the AU 390, aside from that, I think you
23 testified you didn't see anything that would violate AS 3, is
24 that right?

25 A. Correct, I did not.

J34dmid5

Lundelius - cross

1 Q. And I believe you testified that the allowance, that
2 involves a lot of subjectivity when it comes to the financial
3 institution's determination of the allowance, right?

4 A. It does, yes.

5 Q. I think you called it "squishy"?

6 A. There is some element to it, the qualitative factors that
7 tend to be squishy, yes, because they're very subjective.

8 Q. And you said the auditor has a daunting task of evaluating
9 the judgment calls the financial institution makes, right?

10 A. In my opinion, yes.

11 Q. And when they are evaluating that, they have to explain
12 their judgments in these workpapers, right?

13 A. That is correct, yes.

14 Q. And those explanations are important, right?

15 A. They're required and the issue is how much explanation is
16 really needed, that's the issue that's open, but there is an
17 explanation required, yes.

18 Q. So you want to do the best job possible with an
19 explanation, right?

20 A. I think a monitor does, yes, as a general rule, but there
21 is a difference between a standard and trying to do the best
22 job possible, but the standard is not well set out and it is
23 not very clear.

24 Q. But we can agree that the word you put in the workpapers,
25 how you explain your judgment, they matter, right?

J34dmid5

Lundelius - cross

1 A. Yes, they matter, yes.

2 Q. And sometimes these memos explaining the judgment, they can
3 be hundreds of pages, right?

4 A. They can, yes.

5 Q. Now, Mr. Lundelius, even though you reviewed documents in
6 this case, you didn't actually talk to any of the auditors, did
7 you?

8 A. I did not, no.

9 Q. So you have no way of knowing sort of what procedures they
10 actually did in the case, right?

11 A. No, that's not correct. The audit standards say that the
12 audit workpapers need to be written at such a level, and it is,
13 such that it is possible that a knowledgeable CPA can come in
14 and pick them up and understand the procedures that were
15 performed. That's the standard. As far as I could tell for
16 the documents that we had, particularly for the six firms we
17 had fairly complete documents, I was able to do that.

18 Q. But -- so as to these workpapers, you said you reviewed
19 certain changes, right?

20 A. I'm sorry?

21 Q. You reviewed edits to the workpapers, right?

22 A. Yes, I did.

23 Q. And those were handwritten edits you saw on the documents,
24 right?

25 A. Some were handwritten, some were done in a Word document.

J34dmid5

Lundelius - cross

1 Q. And you understand that the eAudIT system doesn't track
2 every change made in the workpapers, right?

3 A. That is my understanding, yes.

4 Q. So there is no way of knowing exactly what changes were
5 made to the workpapers, right?

6 A. There is no way of knowing what was changed up to the
7 document completion date.

8 Q. No way of knowing without talking to the actual auditors,
9 right?

10 A. Well, we actually had -- for many of these workpapers, we
11 actually had an original that was marked up in some way, and
12 then we saw the changes that were indicated and then we could
13 get to the final version of the workpapers. So we actually had
14 multiple workpapers that could allow us to step through that
15 process.

16 Q. This is assuming that any changes -- that the only changes
17 were handwritten comments, right?

18 A. Well, yeah, I think the handwritten comments and the emails
19 and the word -- insertions in the Word documents, those were I
20 think the principal elements that were related to this case.
21 So I think we've got the key points. There could very well
22 have been some phone conversation or something like that that,
23 you know --

24 Q. Right. Mr. Lundelius, so, for example, somebody could call
25 the auditor saying make this change in the document and they

J34dmid5

1 might just make it, right, and you would never see it?

2 A. That certainly is possible, though at least for the ones
3 that I think were relevant to this case, I think we've pretty
4 much found documentation for that.

5 Q. But you are aware that in this case some changes were
6 actually made directly in the workpapers, right?

7 A. No, I am not aware but it wouldn't surprise me.

8 Q. And you didn't talk to any of those auditors who had made
9 those changes, right?

10 A. Well, I wouldn't have the record of what the change was so,
11 no, I did not.

12 Q. So you don't have any way to evaluate those kind of
13 changes?

14 A. Yeah. It's -- again, the changes that I could evaluate
15 were the ones where we had some paper trail.

16 MS. ESTES: One moment, your Honor.

17 (Pause)

18 No further questions.

19 THE COURT: All right. Anything further?

20 MS. LESTER: No, your Honor, nothing from us.

21 MR. WEDDLE: Nothing, your Honor.

22 THE COURT: Thank you. You may step down.

23 (Witness excused)

24 MR. BOXER: Your Honor, we call David Middendorf.

25 THE COURT: All right.

J34dmid5

Middendorf- direct

1 Sir, please have a seat, and please raise your right
2 hand and you will be sworn in.

3 DAVID MIDDENDORF,

4 a defendant herein, called as a witness by
5 Defendant Middendorf, having been duly sworn,
6 testified as follows:

7 THE CLERK: Please state your full name and spell your
8 last name slowly for the record.

9 THE WITNESS: David Middendorf, M-i-d-d-e-n-d-o-r-f.

10 THE CLERK: Thank you.

11 MR. BOXER: May I, your Honor?

12 THE COURT: Yes.

13 DIRECT EXAMINATION

14 BY MR. BOXER:

15 Q. Mr. Middendorf, I would like to direct your attention to
16 the day of February 6, 2017.

17 A. OK.

18 Q. And please tell the jury what happened that day.

19 A. On February 6th I had an all day meeting with my boss,
20 Scott Marcello, and my peer, the other national managing
21 partner of audit operations for KPMG.

22 Q. Did you receive anything during the day?

23 A. I received something either over the weekend or that day
24 that was a calendar invitation for a call that evening at
25 8:30 p.m. Eastern Time.

J34dmid5

Middendorf- direct

1 Q. And do you recall from whom the invitation was from?

2 A. From Brian Sweet.

3 Q. And do you remember if any other KPMG employees were
4 invited to the call?

5 A. Tom Whittle.

6 Q. Do you recall if the invite had a subject matter
7 referenced?

8 A. I think it was something generic, like catch up or chat.

9 Q. When you received the invite, did you know why, the purpose
10 of the call?

11 A. No, I did not.

12 Q. What happened after you received the invite?

13 A. So the meeting I referred to earlier, there was a dinner
14 following. I left the dinner in time to get into the cab,
15 taxi, to take the call at 8:30, so I dialed into the conference
16 call number that was on that calendar invitation.

17 Q. And what happened after you dialed into the call?

18 A. I dialed in and Mr. Whittle and Mr. Sweet were both on the
19 phone.

20 Q. Who spoke first?

21 A. I believe it was Mr. Whittle.

22 Q. And do you recall what he said?

23 A. I believe he said Mr. Sweet had obtained the entire PCAOB
24 inspection list for KPMG for 2017.

25 Q. And did you respond to that statement?

J34dmid5

Middendorf- direct

1 A. I don't recall if I -- well, I did respond to that
2 statement. I asked Mr. Sweet how he had obtained that
3 information, and he had responded that he -- it came to him
4 anonymously and he was not seeking it out.

5 Q. And what happened after Mr. Sweet said he received it
6 anonymously and was not seeking it out?

7 A. He commenced walking me through the list, the information
8 that he had.

9 Q. And while Mr. Sweet was walking through the list, what did
10 you do?

11 A. So I was on my cell phone with my headphones and I didn't
12 have any paper with me, so I started putting that information
13 into the notes app on my iPhone.

14 Q. And why did you put it into your notes app?

15 A. To me he was giving me information. I needed to record it
16 so I could share it when I told my boss about it.

17 Q. And do you recall, besides the names, if Mr. Sweet said
18 anything else about the list?

19 A. As he went through the list of companies, he would on some
20 companies have other information, who the audit partner might
21 be, what the focus areas might be, etc.

22 Q. He provided that information during the call?

23 A. Yes, but I don't believe it was for every company on the
24 list.

25 Q. And what happened after that?

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Middendorf- direct

1 A. So I mentioned earlier I was in a taxicab. I got to my
2 apartment in New York. I got out of the taxi, got on my
3 elevator and I dropped off the call, and so when I got up to my
4 apartment I dialed back into the call and Mr. Whittle and
5 Mr. Sweet were still on the call.

6 Q. And what happened after you dialed back into the call?

7 A. So I don't remember what part of the information Mr. Sweet
8 had gone through, but he either finished going through the
9 list. But at some point I asked him to go back through it
10 because having dropped off and trying to take notes on my phone
11 and my thumbs don't type so fast, I wanted to make sure I had
12 all the information that he was sharing.

13 Q. And did Mr. Sweet go through the list again?

14 A. He did.

15 Q. And what happened after he went through the list?

16 A. So at the end of the call, I made a statement that don't do
17 anything with this information until I have a chance to talk to
18 my boss, Mr. Marcello.

19 Q. Is that Scott Marcello?

20 A. Scott Marcello, Vice Chair of Audit.

21 Q. That was my next question.

22 Did Mr. Sweet indicate whether or not he had already
23 told anyone besides you and Mr. Whittle about the list?

24 A. No, he did not.

25 Q. Was the information Mr. Sweet shared with you over this

J34dmid5

Middendorf- direct

1 phone call different from previous information you had received
2 from Mr. Sweet?

3 A. Yes, it was.

4 Q. In what way?

5 A. It appeared to be the entire inspection list for KPMG.

6 Q. And did it come at a particular time that made it different
7 than previous information you had received from Mr. Sweet?

8 A. Yes. So February 6th is the right during the heart of
9 audits, so these audits are live versus being in the
10 documentation period.

11 Q. And what happened after the call between the three of you
12 concluded?

13 A. So we concluded the call. Mr. Whittle called me back I'll
14 say within a few minutes, and we had a short discussion about,
15 wow --

16 Q. Who said "Wow"?

17 A. I can't remember, maybe both of us, that the conversation
18 was around I wonder where Brian is getting this information.

19 Q. And did you have any discussion with Mr. Whittle at that
20 time about Mr. Marcello?

21 A. No. I think it was clear on the first call that I wanted
22 to talk to Mr. Marcello.

23 Q. And did you speak with any -- about any other things with
24 Mr. Whittle on that second call?

25 A. Since I had been out of pocket all day, I believe we

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Middendorf- direct

1 chatted about a couple of other things he had on his list to
2 cover with me.

3 Q. What happened the next day, on February 7th?

4 A. So the next morning I went to my office, and KPMG has a
5 system called the Partner Rotation System. It is basically a
6 listing of all the firm's clients and who the partners are. So
7 I went into the PRS system to -- there were some of the
8 companies on that list I had never heard of before, but the big
9 clients, I know some companies so I was basically verifying are
10 they clients of the firm.

11 Q. And did you verify that they were clients of the firm?

12 A. Yes.

13 Q. Was there a reason why you thought it necessary to verify
14 that they were clients of the firm?

15 A. Although it appeared the information Mr. Sweet had was
16 legitimate, I think if the list includes all KPMG clients, it
17 kind of establishes the legitimacy. And when I talked to
18 Mr. Marcello, I wanted to make sure it seemed like it was the
19 official list.

20 Q. And when you went on the PRS system, did you any more
21 information, additional information, into your iPhone?

22 A. I might have picked up partner names on ones that Mr. Sweet
23 did not have.

24 Q. What happened after that?

25 A. So later that afternoon I had a meeting with Mr. Marcello,

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Middendorf- direct

1 and part of that meeting I pulled out my iPhone and we sat next
2 to each other. And I walked him through -- well, I first had
3 told him about the phone call the night before with Mr. Whittle
4 and Mr. Sweet, and then I walked him through the list that was
5 on my iPhone.

6 Q. And did you say anything to Mr. Marcello to distinguish
7 this information from previous information that you had
8 received from Mr. Sweet?

9 A. I did. I compared it to 2016, where it was a partial list
10 and it was during the document completion period, and had
11 pointed out this appeared to be the entire list and also was
12 during the audits. These audits were live. We did not reach
13 the report release date on I'd say most if not all of these
14 compliance.

15 Q. And what did Mr. Marcello say?

16 A. He kind of looked at me, and I think it's the question of,
17 you know, OK, what do we do from here? So we had a
18 conversation about the information. And basically I said let's
19 give some thought to, you know, what are the options here as it
20 relates to what do we do with this information.

21 Q. And did you have a meeting later that day where the topic
22 of the list came up again?

23 A. I did.

24 Q. And when was that, approximately?

25 A. Sometime, I'd say, late afternoon/early evening.

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Middendorf- direct

1 Q. And where was the meeting?

2 A. It was with George Hermann, my Chief Auditor, in his
3 conference room.

4 Q. And what was the planned purpose of the meeting?

5 A. We had a meeting set up with George Hermann and myself and
6 a senior manager to discuss sampling, which is one of the audit
7 procedures we do when we are looking at making changes to our
8 sampling methodology. So, that was the purpose of the meeting.

9 Q. And tell us what happened at the sampling meeting with
10 Mr. Hermann.

11 A. So I don't remember all the details of the actual sampling
12 meeting, but we had the sampling meeting with myself,
13 Mr. Hermann and the senior manager, and at the end of that
14 meeting the senior manager excused him so I was left with
15 Mr. Hermann.

16 Q. And what did you say to Mr. Hermann at that time?

17 A. So I told him that the night before I had been on a call
18 where I found out that Brian Sweet had obtained the list, the
19 inspection list, for 2017, and I had had a conversation earlier
20 that day with my boss, Mr. Marcello, and so I was just filling
21 in Mr. Hermann.

22 Q. Did you tell Mr. Hermann that you had informed Mr. Marcello
23 about the list?

24 A. I did.

25 Q. And what was Mr. Hermann's response?

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Middendorf- direct

1 A. I'd say very agitated, very maybe fired up is the right
2 term. He had made some derogatory comments about Mr. Sweet and
3 that we shouldn't have this information.

4 Q. And did that reaction make an impression on you?

5 A. It did.

6 Q. And in what way?

7 A. It was a data point from a person that I had high regard
8 for, that it upset him that the firm had this information.

9 Q. And by "data point" what do you mean?

10 A. A piece of information. So I'm processing information as
11 it relates to my views on having the information, and he shared
12 his views on that he was very upset about having this
13 information.

14 Q. And what did you do after that meeting with Mr. Hermann?

15 A. So at some point -- I can't remember if it was later that
16 evening or the next day -- I informed Mr. Marcello of my
17 conversation with Mr. Hermann.

18 Q. Do you recall what Mr. Marcello said at that point?

19 A. I don't. He -- both of us had known Mr. Hermann for many
20 years, so he has high regard, or my belief was he had high
21 regard for Mr. Hermann. So, I thought it was important to
22 share that with Mr. Marcello also.

23 Q. If I could turn your attention to the next day,
24 February 8th, 2017.

25 Did you receive a calendar invite for a call on that

J34dmid5

Middendorf- direct

1 day?

2 A. I did.

3 Q. And from whom?

4 A. Laurie Mullen.

5 Q. And who is Laurie Mullen?

6 A. Laurie was the West Region professional practice partner,
7 reporting directly to me.

8 Q. She was one of your direct reports, correct?

9 A. Correct.

10 Q. And did you have an understanding when you saw that
11 calendar invite as to why Ms. Mullen wanted to speak with you?

12 A. I did not. It also had a subject line that was somewhat
13 generic, catch up, or something similar to that.

14 Q. And did you speak with Ms. Mullen on the 8th?

15 A. I did.

16 Q. And what do you recall about that conversation?

17 A. So she kind of answered the phone, and she kind of went
18 right into that Diana Kunz, an audit partner in Chicago, had
19 received a call from Brian Sweet on Friday, February 3rd, so
20 the Friday before, and had told Ms. Kunz that her engagement
21 was going to be inspected by the PCAOB and he requested access
22 to her workpapers.

23 Q. Did she say anything else about what had occurred?

24 A. Yes. The way she found out was Ms. Kunz told her business
25 unit partner in charge, John Rodi, who had told his I'll say

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Middendorf- direct

1 counterpart leader in Chicago, Dave Marino, that information,
2 and Mr. Marino and/or Mr. Rodi had called Ms. Mullen about that
3 whole chain of events.

4 Q. And did Ms. Mullen say anything whether or not -- as to
5 whether or not Mr. Sweet in fact did obtain access to
6 Ms. Kunz's engagement files?

7 A. I think it was her view that access had been granted and
8 then later revoked during the period between February 3rd and
9 when she talked to me on February 8th.

10 Q. And what did you say to Ms. Mullen?

11 A. I told her that had she called me two days prior, this
12 would have been news to me, but the fact that -- I told her
13 about my call on Monday evening, February 6th, that Mr. Whittle
14 and Mr. Sweet had called me. So I said I was aware that we had
15 the PCAOB inspection information.

16 Q. Did you say anything with respect to Scott Marcello to
17 Ms. Mullen?

18 A. I did. I told her -- as part of that conversation, I told
19 her when I had been on the call Monday evening, and the next
20 day I had told my boss Scott Marcello and we were working on
21 it.

22 Q. And what did Ms. Mullen say in response?

23 A. She was also, I'd say, very upset and animated that Brian
24 had gotten this information and that we needed to act on it.
25 And I told her I had told Mr. Marcello and we were working on

J34dmid5

Middendorf- direct

1 it. And she kind of ended the call with, well, let's make sure
2 we follow up.

3 Q. And after your call with Ms. Mullen on the 8th, what did
4 you do?

5 A. I'm trying to think what happened on the 9th.

6 Q. Do you remember having a meeting right after your call --

7 A. Oh, yes, I do.

8 Q. Who did you have the meeting with?

9 A. Yes. So based on the call with Ms. Mullen, I was very
10 upset that Mr. Sweet had acted on the information, that I had
11 thought I was clear on the call on the 6th to not do anything
12 with the information. So I went to Mr. Whittle's office and
13 told him to please -- or told him about the call with
14 Ms. Mullen and told him that Brian apparently had reached out
15 to a partner before he had even told me he had the list and to
16 call him to cease and desist and stop talking to anybody about
17 this information.

18 Q. For who to call whom?

19 A. For Mr. Whittle to call Mr. Sweet.

20 Q. Did Mr. Whittle during that conversation make any mention
21 of the fact as to whether he knew about the list on
22 February 3rd, the Friday before your call with him?

23 A. He seemed surprised by the fact that Mr. Sweet had reached
24 out to anybody with that information.

25 Q. And what did you do after that conversation?

J34dmid5

Middendorf- direct

1 A. So he -- Mr. Whittle came back to me in some period of
2 time, maybe within an hour, maybe within two, and basically
3 said he had delivered the message to Mr. Sweet, and when he
4 talked to Mr. Sweet he denied that he had actually reached out
5 to Ms. Kunz. And I looked at Tom and said, well, how else
6 would she have known. There was only, you know, myself,
7 Mr. Marcello, Tom and Brian who at that point I thought knew
8 and of course the folks in Chicago and -- but Tom said
9 basically the message was delivered.

10 Q. So Mr. Sweet denied to Mr. Whittle that Mr. Sweet had
11 reached out to Ms. Kunz?

12 A. Correct.

13 Q. And after your conversation with Mr. Whittle, did you speak
14 to Mr. Marcello?

15 A. I believe so. I can't remember if it was later on the
16 8th or on the 9th, but I wanted to inform him of my
17 conversation with Ms. Mullen.

18 Q. And did you do that later on the 8th or on the 9th?

19 A. Yes.

20 Q. And what happened on the 10th?

21 A. So Ms. Mullen circled back with me. I had not reached out
22 to her so she reached out to me on just any updates that I had.

23 Q. And what did you tell her?

24 A. I told her that I had been informing Mr. Marcello of all
25 the conversations that I had had and that we were working on

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Middendorf- direct

1 it, and I kind of took a view that she didn't find my answer
2 fulfilling.

3 Q. What made you perceive that?

4 A. She told me that Mr. Marcello was going to be in Chicago on
5 Monday meeting with a client and that her and Mr. Marino and
6 Mr. Rodi were going to approach Mr. Marcello in Chicago on the
7 13th.

8 Q. And what did you say in response to Ms. Mullen?

9 A. I said, that's fine. He is aware of everything I am aware
10 of at that point.

11 Q. And after that call on February 10th with Ms. Mullen, did
12 you speak to Mr. Marcello?

13 A. I did.

14 Q. And what happened during that conversation?

15 A. So I talked to him -- once again, I don't remember the
16 exact date and time, but I think sometime over the weekend I
17 had a conversation with him about when he got to Chicago, that
18 it was the intent of Ms. Mullen, Mr. Rodi and Mr. Marino to
19 talk to him about this matter.

20 Q. And what did Mr. Marcello say?

21 A. Pretty much, fine.

22 Q. And the Monday after that weekend was February 13th,
23 correct?

24 A. Correct.

25 Q. And did you have any calls on the 13th about the list?

J34dmid5

Middendorf- direct

1 A. I did. So Mr. Marcello called me at some point, I'd say,
2 early afternoon, and said he thinks the appropriate path is to
3 notify Judge Holmes. He is the Vice Chair of Legal Risk and
4 Regulatory, at KPMG.

5 Q. And what did you say?

6 A. I said I agree.

7 Q. And what happened after that?

8 A. At some point -- I can't remember within, you know, the
9 next hour or few -- there was an email from Mr. Marcello to
10 Judge Holmes and either to me or copying me saying Dave and I
11 have a PCAOB matter we need to discuss with you.

12 Q. And was a call arranged with Mr. Holmes?

13 A. Yes. So at some point there was a calendar invitation that
14 came out to schedule a call for 7 a.m. Eastern Time the next
15 morning, February 14th.

16 Q. And did the call take place at that time?

17 A. Yes, it did.

18 Q. Who was on the call?

19 A. Myself and Mr. Marcello and Mr. Holmes.

20 Q. And what do you remember about who said what during that
21 call?

22 A. So my recollection is Mr. Marcello I'll say gave a kickoff
23 that, you know, we determined that we may have the PCAOB
24 inspection list and Dave has more of the details so I'm going
25 to let him walk through them.

J34dmid5

Middendorf- direct

1 Q. And did you walk through the details that you had?

2 A. I did. I walked Judge Holmes and Mr. Marcello had heard
3 about it before, but I walked him through the sequence of
4 events as I knew them starting on the February 6th call that I
5 received.

6 Q. Was it your understanding that Mr. Holmes was learning
7 about this information for the first time?

8 A. It was.

9 Q. And what do you base that understanding on?

10 A. He didn't indicate that he had heard it from anyone else
11 and he seemed certainly bothered by having the information and
12 made a comment, "I think we're going to need to take this to
13 the PCAOB."

14 Q. Did he also make a comment about informing any of his
15 superiors at KPMG?

16 A. Yes. And he said he would need to inform the CEO of KPMG,
17 Lynn Doughtie.

18 Q. Is it fair to say, based on his comment, that you
19 understood Ms. Doughtie did not know about this information?

20 A. Correct.

21 Q. What happened after that?

22 A. So that call was the morning of the 14th. I had a client
23 engagement that I needed to go to, so I flew to Dallas. And so
24 later on the 14th, I would say sometime in the evening, I got
25 an email from Mark Rubino, who worked in the --

J34dmid5

Middendorf- direct

1 Q. Who is Mark Rubino?

2 A. He is the Associate General Counsel at KPMG.

3 Q. Do you recall what he said in the email?

4 A. I think it was also fairly generic of I need to talk to you
5 about something. Having been around the firm a long time, I
6 assumed it related to the conversation we had with Judge Holmes
7 earlier that day.

8 Q. And how did you respond to Mr. Rubino?

9 A. I told him that I was out of town with client meetings and
10 gave him some windows of when I was available for a call the
11 next day.

12 Q. And did you have a call with Mr. Rubino the next day?

13 A. I did.

14 Q. And what do you recall about -- what do you recollect about
15 the conversation you had with Mr. Rubino the next day?

16 A. I think Mr. Rubino started by just saying I'm following up
17 on the conversation you and Scott had with Judge Holmes
18 yesterday and if you can walk me through what you walked him
19 through.

20 Q. Did you do that?

21 A. I did.

22 Q. And what did he say?

23 A. Not a lot. I think he was just taking notes and maybe
24 asking follow along questions.

25 Q. Did there come a time when he asked some general follow

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Middendorf- direct

1 along questions?

2 A. Yeah. At some point he had said, you know, is there
3 anything else or whether I volunteered it. I told him about
4 the 2016 information.

5 Q. What did you tell him?

6 A. I had told him that in 2016 we had gotten some information
7 from the PCAOB, apparently through Brian Sweet anonymously,
8 that there was a small group of clients that we thought might
9 be inspected and we had done rereviews.

10 Q. And based on Mr. Rubino's words, did you have the
11 impression as to whether Mr. Rubino had heard that information
12 prior to you telling him?

13 MS. ESTES: Objection.

14 THE COURT: Overruled.

15 A. Yes.

16 Q. Yes?

17 A. Yes, I believe he had not heard of that information before.

18 Q. And why do you say that?

19 A. Because he seemed bothered by me telling him that because
20 he had not heard that yet.

21 Q. And did he ask you at some point why what happened in 2016
22 didn't bother you?

23 A. Yeah. I had told him because of being in the document
24 completion period and I said it was probably a poor judgment on
25 my part.

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Middendorf- direct

1 Q. Did he say anything -- withdrawn.

2 Did he make any requests regarding the list that you
3 learned about on February 6, 2017?

4 A. Yes, he did. He asked me to send him the list. I told him
5 that it was in my notes app on my iPhone and I had no idea how
6 to cut and paste or, you know, send -- forward that onto him,
7 so I said I would put it in a Word document and email it to
8 him.

9 Q. And did you do that?

10 A. Yes, I did.

11 Q. And did you do that on September 15th, after that phone
12 call?

13 A. February 15th.

14 Q. Excuse me. February 15th. Thank you.

15 A. Yes.

16 Q. After that phone call?

17 A. Yes.

18 Q. Did there come a time, Mr. Middendorf, when KPMG put you on
19 administrative leave?

20 A. Yes, probably the first week of March.

21 Q. And did there come a time when KPMG removed you from the
22 KPMG partnership?

23 A. Yes.

24 Q. When was that?

25 A. April 10th.

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Middendorf- direct

1 Q. Of what year?

2 A. 2017.

3 Q. And did there come a time when the SEC brought a lawsuit
4 against you alleging a violation of Section 102(e)?

5 MS. ESTES: Objection. Relevance.

6 THE COURT: Overruled.

7 A. Yes. The same day I was indicted for this matter, crime, I
8 also received a civil action by the SEC.

9 MR. BOXER: I am going to change gears at this point,
10 your Honor. Is this a convenient time for a break or should I
11 keep going?

12 THE COURT: Why don't we take a ten-minute break.

13 Folks, we will take ten minutes. Please leave your
14 notepads on your chairs. We will be in recess for ten minutes.

15 (Continued on next page)

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1 (Jury not present)

2 THE COURT: You may be seated.

3 You can step down.

4 (Recess)

5 (Continued on next page)

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Middendorf - direct

1 MR. WEDDLE: Your Honor, can I raise one thing very
2 quickly? I don't think it affects whether the witness takes
3 the stand or not.

4 With respect to the certification that I talked to
5 your Honor about before, to facilitate Verizon's work in
6 confirming the information, I would like to send them the
7 spreadsheet that was produced to us in discovery. My
8 understanding that is a spreadsheet that came from Verizon to
9 KPMG to the Government to us. I think it is covered by
10 protective order and would require Verizon to sign the
11 protective order before we send it to them but the protective
12 order also permits your Honor to order that we can do it.

13 So, I request that your Honor order that we can send
14 it back to Verizon.

15 MS. KRAMER: No objection. I think we would like to
16 be heard before this comes in on 403 and 401 grounds, but
17 that's it. No objection to the --

18 THE COURT: As long as they treat it as confidential
19 you are permitted to send it to them and they are permitted to
20 review it.

21 MR. WEDDLE: Thank you, your Honor.

22 THE COURT: Ready for the jury?

23 MR. BOXER: Yes, your Honor.

24 (Continued on next page)

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Middendorf - direct

1 (Jury present)

2 THE COURT: Mr. Boxer, you may proceed.

3 MR. BOXER: Thank you, your Honor.

4 BY MR. BOXER:

5 Q. Mr. Middendorf, how old are you?

6 A. 54 years old.

7 Q. Where do you reside?

8 A. Marietta, Georgia.

9 Q. What is your educational background?

10 A. I received a bachelor of business administration degree
11 from the University of Cincinnati.

12 Q. Is that where you were raised, in Cincinnati?

13 A. I was.

14 Q. And, do you have a family?

15 A. I do.

16 Q. Would you describe your family?

17 A. I have a wife I have been married to, it will be 25 years
18 in May, and I have three daughters; 23 and 17-year-old twins.

19 Q. And, after graduating from college, how were you employed?

20 A. I began straight out of college with a firm known as Peat
21 Marwick, Mitchell & Co. which, within after about six months
22 after I started, became now what is known as KPMG.

23 Q. And what year was that?

24 A. 1987.

25 Q. And, when you started with what's now known as KPMG, in

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Middendorf - direct

1 which office did you work?

2 A. Cincinnati, Ohio.

3 Q. And what kind of work did you do there?

4 A. So, I started out as a staff accountant. The typical path
5 is staff accountant for a couple of years, senior accountant
6 for two or three years, manager usually two years, senior
7 manager for some number of years, five, six, seven years, and
8 then partner.

9 Q. And, what kind of engagements did you work on when you were
10 staff accountant and a manager in the other positions you just
11 described?

12 A. Yes. I have been in the audit practice of KPMG for my
13 entire career.

14 Q. And, did you have any speciality or area of expertise
15 within the audit practice?

16 A. I did. KPMG Cincinnati had a new client at the time, it
17 was called Federated Department Stores. It is what is now
18 Macy's. So, I grew up on that account so I became a retail
19 expert.

20 Q. And we will go through it in more detail but at the time of
21 your administrative leave in 2017, had you worked for any other
22 company besides KPMG?

23 A. No. 30 years at KPMG.

24 Q. Did you become a CPA at some point?

25 A. I did.

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Middendorf - direct

1 Q. Certified public accountant?

2 A. Yes.

3 Q. When was that?

4 A. I believe I became certified in 1989.

5 Q. And, after working in Cincinnati at Peat Marwick -- now
6 KPMG -- what did you do next?

7 A. I spent I guess nine, almost 10 years in the Cincinnati
8 office of KPMG. I was, by that point, a senior manager, and
9 the firm asked me to relocate to New York to the national
10 office on a rotational assignment.

11 Q. And the national office is sometimes referred to as DPP?
12 Is that correct?

13 A. Yes; the Department of Professional Practice or DPP.

14 Q. And so you did that in what year?

15 A. My wife and I had a 1-year-old at the time, moved to New
16 York in April of 1997.

17 Q. And, while you were at DPP at that time did you become a
18 partner of KPMG?

19 A. Yes.

20 Q. And, when was that?

21 A. July 1, 1998.

22 Q. And, can you explain to the jury what it means to be a
23 partner at a firm like KPMG?

24 A. So, a partner is an owner in the firm so although you might
25 think of the typical partnership being two or three people or

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1 10 people, KPMG has 2,000 plus partners. So, I became an owner
2 as part of one of those 2,000 people.

3 Q. And, while you were -- by the way, how long were you in DPP
4 in New York when you started in 1997? How long did that last
5 for?

6 A. I moved there in April of '97, made partner July 1, 1998,
7 and moved back to Cincinnati basically July 1, 1999.

8 Q. And when you were in DPP between 1997 and 1999, what kind
9 of work did you do?

10 A. There are various pieces of the national office. I spent
11 most of my time, we call it the practice advisory group. So,
12 engagement teams call the national office with their problems,
13 their technical matters, issues they may have with the client
14 and what is the proper accounting, etc.

15 Q. And, did you take phone calls from the field on any
16 particular areas of, or questions about technical accounting
17 issues when you were at DPP?

18 A. So, having spent at that point 10 years, probably nine of
19 my 10 years as a retail person, I certainly handled lots of the
20 retail inquiries but the purpose of going to the national
21 office was to get, I will say a broad base of experience and a
22 lot of different technical areas with the goal of, as a partner
23 who has been through the national office, you become a very
24 strong partner that hopefully will be assigned to larger
25 engagements.

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1 Q. And did you in fact have a broad experience and broad
2 exposure when you were at DPP?

3 A. I did. I probably answered somewhere in the 1,200 to 1,500
4 inquiries during my two-plus year tenure in the national office
5 or in DPP.

6 Q. So, in 1999 you left DPP, right?

7 A. Correct.

8 Q. And tell us where you went and why.

9 A. So, the why is because the firm asked me to. They asked
10 that I be the lead audit partner on what was still at that
11 point known as Federated Department Stores that is now Macy's.
12 So, I moved my wife and then three and a half-year-old back to
13 Cincinnati to become the lead partner on Macy's.

14 Q. What does that mean to be the lead partner on Macy's or any
15 audit client of KPMG?

16 A. So, as I mentioned before, these different levels of
17 staff -- senior manager, senior manager, the partner is the
18 person who signs the opinion, so when we do our audits,
19 responsible for planning the audit and making risk assessments
20 and conducting the audit procedures which may be done by all
21 these individuals, staff and managers, etc., but the ultimate
22 conclusions that are reached and it's the partner who signs the
23 firm's name signed KPMG, LLP, to the opinion of the client's
24 financial statements.

25 Q. And when you were the lead engagement partner of Federated

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Middendorf - direct

1 or Macy's, would you attend meetings of the Macy's audit
2 committee?

3 A. Yes, I would.

4 Q. And why did that occur?

5 A. So, I will just say the typical board of a public company,
6 the audit committee meets, I will say, sometime between four
7 and maybe eight times a year so part of my responsibility as
8 the lead partner would be to communicate not just with the
9 management of the company but with the audit committee who is
10 really responsible for the oversight of the auditor, the audit
11 firm and its relationship with the company.

12 So, at meetings earlier in the year you would present
13 the audit plan so you would present to the audit committee this
14 is our plan on how we are going to execute the audit. When the
15 company is ready to file its financial statements, which have
16 been talked about a number of times the last few weeks, around
17 that end of February time period we would have an audit
18 committee meeting to go over the findings of our audit and
19 share those with the audit committee before we issued our
20 opinion.

21 Q. And for how long were you the lead engagement partner on
22 the Macy's audit?

23 A. So, when we moved back to Cincinnati, the old rules were a
24 seven-year rotation, the maximum time you could spend as a
25 partner.

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Middendorf - direct

1 Q. As the lead engagement partner?

2 A. As the lead engagement partner.

3 And, during my tenure, it was maybe two or three years
4 into my tenure on Macy's is when the Sarbanes-Oxley Act was
5 issued which changed that to a five-year limit to be the --

6 Q. So, by 2004 you needed to come off as the -- you needed to
7 no longer be the lead engagement partner on Macy's, correct?

8 A. Correct.

9 Q. So, what happened after that?

10 A. So, the firm had asked me, I would say maybe four years
11 into my Macy's assignment, if I would be willing to relocate to
12 the Dallas area to be the lead partner on the JC Penney
13 engagement.

14 Q. And what did you say?

15 A. I said yes.

16 Q. And so, when did you start as the lead partner on the JC
17 Penney engagement?

18 A. So, the summer, I guess -- we moved the family July 1,
19 2004, and so I would have signed for that fiscal year of 2004
20 would have been my first year signing on the JC Penney
21 engagement.

22 Q. When you say you moved your family, did you now have three
23 children at the time of this move?

24 MS. ESTES: Objection.

25 THE COURT: Sustained.

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Middendorf - direct

1 BY MR. BOXER:

2 Q. How long did you serve as the engagement partner -- lead
3 engagement partner for JC Penney?

4 A. I began for 2004 so I think the 2008 year was my final year
5 under the five-year rotation requirement for the lead audit
6 partner.

7 Q. And while you were the lead audit partner for JC Penney,
8 did you also serve as SEC reviewing partner for other
9 engagements?

10 A. Yes.

11 Q. What is an SEC reviewing partner?

12 A. Yes, so, the SEC reviewing partner designation is the
13 second partner review on public companies. You have to be
14 designated that within KPMG so at some point in my tenure in
15 Dallas I was asked by the leadership of the firm to become an
16 SEC reviewing partner and then served in that role.

17 Q. And is it called SEC reviewing partner because that second
18 review is required by the SEC?

19 MS. ESTES: Object to the leading.

20 THE COURT: Sustained.

21 BY MR. BOXER:

22 Q. Why is it called the SEC reviewing partner?

23 A. There is a requirement to have a second partner review it.
24 Some people refer to it as Concurring Review Partner and other
25 people now call it the Engagement Quality Control Reviewer.

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Middendorf - direct

1 Q. EQ --

2 A. CR.

3 Q. Thank you.

4 How long did you serve as the lead engagement partner
5 for JC Penney?

6 A. Five years.

7 Q. And what happened after, would that be in 2009? What
8 happened next?

9 A. Yes. So, I was approached maybe about three years through
10 my tenure on JC Penney by firm leadership if I would be willing
11 to relocate my family again to Atlanta to become the lead audit
12 engagement partner for the Home Depot.

13 Q. And what did you say?

14 A. I said yes.

15 Q. And when did you become the lead engagement partner for
16 Home Depot?

17 A. So, I moved my family in January of 2009 and
18 reverse-commuted back to Dallas to wrap up JC Penney and then
19 started in 2009 as the lead partner on the Home Depot.

20 Q. And who was the CEO of Home Depot when you became the lead
21 engagement partner?

22 A. Mr. Frank Blake.

23 Q. And, did you meet with Mr. Frank Blake while you were lead
24 engagement partner on Home Depot?

25 A. Yes.

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Middendorf - direct

1 Q. Did you have a practice as to when you would meet with him?

2 A. I did.

3 Q. What was your practice?

4 A. I would meet with Frank on, I will say a regular cadence,
5 approximately quarterly, to discuss various matters. I would
6 keep an agenda of things that I thought about through the
7 quarter that I wanted to make sure he was aware of and then I
8 would also, of course, if there was a matter that I thought
9 required his attention more quickly, I had the ability to reach
10 out to his office and get something scheduled.

11 Q. And those meetings, were they one-on-one or were others
12 present as well?

13 A. One-on-one.

14 Q. And, did you also meet with the audit committee of Home
15 Depot?

16 A. Yes, I did.

17 Q. Was Mr. Blake present at some of those meetings?

18 A. Yes.

19 Q. Did there come a time when you became a professional
20 practice partner or leader of the firm?

21 A. Yes.

22 So, the vice chair of audit at the time asked me
23 pretty much when I arrived in Atlanta in early 2009 if I would
24 also take on the role of the Business Unit Professional
25 Practice Partner for the Mid-South which KPMG defined as

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Middendorf - direct

1 Georgia, Alabama, Tennessee, and Mississippi.

2 Q. And did you take on that role?

3 A. Yes, I did.

4 Q. And what was involved in that role?

5 A. Several different aspects.

6 I think first and foremost was for the audit partners
7 in that geography I was a person they could call if they had an
8 issue, if there was a technical matter, if it was a difficult
9 client situation that maybe they wanted somebody else to come
10 meet with them and talk to their client or to their audit
11 committee and then have interactions with the PCAOB as they
12 would inspect engagements within my geography. We would
13 orchestrate to make sure the team was prepared and participated
14 in that inspection.

15 Q. And, did there come a time when you were elected or
16 appointed to the Board of Directors of KPMG?

17 A. Yes.

18 Q. When was that?

19 A. So, while I was still in Dallas, I was asked by a member of
20 the nominating committee of the Board if I would consider
21 putting my name in to run for the Board. I told him at that
22 point in time because I was wrapping up JC Penney, moving my
23 family to Atlanta, starting my new engagement with Home Depot,
24 I didn't think it was the right time to do that.

25 Q. Did there come a time when you agreed to be nominated for

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Middendorf - direct

1 the board?

2 A. Yes. Once I was settled in Atlanta later that year in 2009
3 I was asked again if I would consider that and I said my family
4 is settled, I have wrapped up my old client, am comfortable
5 with my new client, and I would go through the nomination
6 process.

7 Q. And were you elected to serve on the board?

8 A. Yes, I was.

9 Q. And for how long did you serve on the Board of Directors of
10 KPMG?

11 A. It is typically a five-year term and I completed my full
12 five-year term.

13 Q. And what happened after the five -- withdrawn.

14 Did you serve as lead engagement partner in Home Depot
15 for five years?

16 A. Yes, I did.

17 Q. What happened after those five years were over?

18 A. Well, like the other situations before that time ended, I
19 would say probably sometime six months or a year before I was
20 going to be rotating off of the Home Depot engagement, I was
21 approached by Jim Liddy, the vice chair of audit at the time.
22 I think I approached him about what is my next assignment? I
23 assumed it would be another client assignment and I met with
24 Mr. Liddy at his office in New York and he asked me if I would
25 take on the role of National Managing Partner, Audit Quality

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Middendorf - direct

1 and Professional Practice.

2 Q. And what did you say?

3 A. We talked about what -- why he wanted me to do the role and
4 I had told him my -- I just was in a position with my children
5 that I could not move --

6 MS. ESTES: Objection. Relevance.

7 MR. BOXER: I think he is about to explain the
8 relevance.

9 THE COURT: That's fine. Go ahead.

10 THE WITNESS: That I would not be able to relocate to
11 New York but I would take the position and my family would stay
12 in Marietta and I would commute to New York.

13 BY MR. BOXER:

14 Q. Was that agreeable to Mr. Liddy?

15 A. Yes, it was.

16 Q. Is this what is sometimes called as a commuting arrangement
17 or a commuter package?

18 A. Yes.

19 Q. Was a commuter package uncommon at KPMG?

20 A. No, it was not.

21 Q. Would you say it was common?

22 A. I would say it would be common, in particular, for certain
23 roles within the firm, the top leadership of the firm, almost
24 all of them do not live in New York but their job is in New
25 York.

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Middendorf - direct

1 Q. When did you start as National Managing Partner for Audit
2 Quality and Professional Practice in New York?

3 A. June 1 of 2014.

4 Q. And, did you have a practice as far as when you would be in
5 New York and when you would be in Georgia?

6 A. So, typically if I was going to be in New York I would fly
7 in Monday morning, fly home Thursday evening, but my role
8 involved me being on the road, I will say, a fair amount
9 visiting KPMG offices, visiting with KPMG clients. So,
10 typically if I was in New York it would be Monday through
11 Thursday but I was in other locations quite often.

12 Q. And when you became national managing partner, did you
13 continue to serve as an SEC reviewing partner or the EQCRP? --
14 I think I got the letters wrong.

15 A. EQCR. Yes, I did.

16 Q. Sorry, no P.

17 On what engagements?

18 A. Darden Restaurants, Rent-A-Center, and I went back on to
19 Macy's as the EQCR having been off Macy's for 10 years.

20 Q. Did you have any experience with PCAOB inspections when you
21 were the SEC reviewing partner on those engagements?

22 A. Yes. In 2016 the Darden engagement was inspected and then
23 a couple of months later the Rent-A-Center engagement was
24 inspected.

25 Q. Did there come a time when you were appointed to the PCAOB

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1 SAG?

2 A. Yes.

3 Q. Do you recall approximately when that was?

4 A. The way I would narrow it down, I began my role June of
5 2015, there was a partner in the firm who was in, I will say
6 their term on the SAG, and I would say maybe a year after I was
7 in my role Jay Hanson approached me and said that the partner
8 from KPMG that had been on the SAG, his time was expiring and
9 maybe I should consider joining the SAG.

10 Q. And did you join the SAG?

11 A. I did.

12 Q. And, who is Jay Hanson?

13 A. PCAOB board member.

14 Q. If we could show what's marked Government Exhibit 29, in
15 evidence? If we could scroll down to the third page?

16 Is that your signature, Mr. Middendorf?

17 A. Yes, it is.

18 Q. Do you remember receiving this document?

19 A. I don't remember receiving it timely but having been shown
20 it in evidence or in preparing for the trial, yes.

21 Q. Do you remember receiving it at the time it was dated,
22 November 2015?

23 A. No.

24 Q. Do you remember any inspections, discussions particular to
25 inspections while you were on the SAG?

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1 A. No.

2 Q. What was discussed on the SAG?

3 A. The SAG would have an agenda that the PCAOB had basically
4 established so there would be different things of interest. If
5 the PCAOB had a potential or proposed new auditing standard,
6 maybe that would be covered. I remember at one of the meetings
7 there was a discussion of non-GAAP measures that some companies
8 use.

9 Q. Do you recall receiving any information that you considered
10 confidential to the PCAOB while you were on the SAG?

11 A. No.

12 Q. You mentioned a couple times about PCAOB inspections.
13 Could you -- withdrawn.

14 Did you have personal experience with PCAOB
15 inspections?

16 A. Yes. I was inspected by the PCAOB on one of my audits when
17 I was the lead partner on JC Penney, and I was also -- some of
18 the engagements for which I was the EQCR over my career were
19 also inspected by the PCAOB.

20 Q. And, the inspection of JC Penney when you were the lead
21 partner, do you recall when that was?

22 A. I would say probably about 2007.

23 Q. And, just briefly, do you remember what occurred during the
24 inspection?

25 A. I do, because it was an unusual inspection.

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1 Q. And what was unusual about it?

2 A. The PCAOB has typically done its inspections after the
3 completion of the engagement. I was approached by someone in
4 risk management within the firm and asked if I would be willing
5 to undergo an in-flight inspection by the PCAOB.

6 Q. What does that mean, an in-flight inspection?

7 A. While the audit was still progressing.

8 Q. And, did you agree?

9 A. I didn't feel like I had a whole lot of choice, it was
10 probably a rhetorical question but, yes, I agreed and it was
11 the purpose of it was driven because audit standard 5 on
12 internal controls was a new standard that was issued.

13 Q. And, the PCAOB wanted to observe how the engagement was
14 applying audit standard 5 in real-time; is that right?

15 A. Correct; on what we were doing different. Audit Standard 5
16 replaced Audit Standard 2 on the audit of internal controls so
17 they were interested in what we were doing different between
18 now being under Audit Standard 5 and having previously been
19 under Audit Standard 2.

20 Q. And after the in-flight inspection concluded, what
21 happened?

22 A. So, the in-flight inspection was only a few days. We
23 completed the audit and then I got selected for what I will
24 calling a normal inspection by the PCAOB that summer.

25 Q. And -- of the audit of JC Penney, correct?

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1 A. Correct.

2 Q. And, approximately when do you recall when you received
3 notice of the inspection?

4 A. I do not recall.

5 Q. Do you have an understanding as to how the PCAOB provides
6 notice of inspections?

7 A. Yes.

8 Q. And, could you describe for the jury your understanding?

9 A. Yes.

10 So, typically the PCAOB notifies someone in Thomas
11 Whittle's group, typically a woman named Meredith Hardesty, and
12 then she sends an e-mail out to the engagement teams that have
13 been selected for inspection.

14 Q. And, does any notice from the PCAOB come before the notice
15 you just described?

16 A. Yes.

17 So, in order to plan and prepare our people for when
18 they might be inspected, they send out a list of cities that
19 they will be going to for inspection. They indicate if it's a
20 financial institution or a non-financial institution. They
21 indicate how many weeks they will be in that location
22 conducting the inspection.

23 Q. And the notice you just described, does that typically come
24 before or after the documentation period closes?

25 A. I don't recall.

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1 Q. And, based on that notice that you just described, are
2 there instances when you are able to determine whether the
3 specific PCAOB inspection -- withdrawn.

4 Are you able to determine some instances which
5 engagement is in particular going to be inspected based on the
6 notice of city and date?

7 A. Yes.

8 Q. And how is that?

9 A. Based on the size of the practice.

10 So, there are certainly some large offices of KPMG and
11 there are smaller offices based on the client makeup, how many
12 financial institutions may be a client in that office. It's, I
13 would say easily determinable. Not in all instances, but in
14 some and in maybe quite a few instances.

15 Q. You have heard testimony during the trial about the opening
16 meeting of the inspection with the PCAOB, correct?

17 A. Yes.

18 Q. Could you describe your experience using JC Penney or any
19 engagement where you were part of the inspection of the opening
20 meeting with the PCAOB?

21 A. Yes.

22 So, I think our view is always like any interaction
23 you would have with someone, a first impression is an important
24 impression so the firm had tailored a PowerPoint presentation
25 that kind of, any KPMG inspection by the PCAOB would look

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1 somewhat similar. Certainly the content within that document
2 would be different and the engagement team would prepare that
3 document to prepare themselves for the opening meeting.

4 Q. And, is the initial meeting with the PCAOB a meeting in
5 person?

6 A. It was at one point but not for a number of years.

7 Q. And your participation in that opening meeting in recent
8 years, was it in person or on the phone?

9 A. On the phone.

10 Q. And, was the PCAOB in person or on the phone at the
11 location of the engagement?

12 A. They were not at the location of the engagement, it was by
13 phone.

14 Q. And, do you have an understanding as to why that practice
15 developed over the PCAOB being on the phone?

16 A. Yes.

17 Q. And, what is your understanding?

18 A. So, the PCAOB, I will say in the early years, if they were
19 coming to an office for a one-week inspection, would not have
20 the opening meeting until the first morning, Monday morning,
21 and I think they determined that it would be more productive
22 for them to maybe hit the ground running on Monday morning.
23 So, they moved the opening meeting back to the week before and
24 since they weren't yet onsite it became a telephonic meeting.

25 Q. You have heard the expression "the best first answer to the

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1 PCAOB?"

2 A. Yes.

3 Q. What do you understand that expression to mean?

4 A. Best first impression, basically. Can you be knowledgeable
5 about the work that you performed that you seem to have a
6 command of the facts.

7 Q. You believe a strong best first answer to the PCAOB at the
8 opening meeting can avoid a comment?

9 A. No.

10 Q. What do you think it can accomplish, a very good best first
11 answer?

12 A. Yes. So, I think like any interaction where it's a first
13 impression what is your first impression if someone is, has
14 command of the facts, it can certainly help the other person.
15 In this case the inspectors have a view of that you know what
16 you are doing in a positive first impression but if the work
17 that supports that, the audit work is not of high quality, it
18 doesn't really matter, the first impression, the quality of the
19 work is not there.

20 Q. Do you have a view if the opening meeting is a poor
21 performance by the engagement partner as to whether or not that
22 can lead to a comment?

23 A. I don't think that, in and of itself, would lead to a
24 comment. I think it's kind of the inverse of what we just
25 chatted. If you had a bad first impression you may get more

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1 questions from a PCAOB inspector because they have a view maybe
2 you don't understand the details of the engagement you signed
3 off on. But, I think as long as your work product, with the
4 audit work that was performed is of high quality, your lack of
5 wowing them with the first impression shouldn't have an impact
6 on whether the quality of the work was there. It make the
7 inspection tougher, but it shouldn't change the outcome.

8 Q. How long does the engagement team have to prepare for that
9 first call, typically?

10 A. Typical notification is three to four weeks.

11 Q. And, is that sufficient time to be prepared?

12 A. Yes.

13 Q. How long do you think is sufficient time for an engagement
14 team to be prepared for a first meeting with the PCAOB for an
15 inspection?

16 A. I think what auditors do for a living and work a lot of
17 hours that the amount of time may get compressed but a week
18 would be sufficient. It would be nice to have more time but
19 you can accomplish it in a week or less.

20 Q. Did you ever work on an engagement team or lead an
21 engagement team of a financial institution?

22 A. No.

23 Q. When you assumed your role as national managing partner,
24 did you become aware of an issue or issues the firm was having
25 with respect to audits of financial institutions?

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1 A. Yes, I did.

2 Q. And, did that concern the auditing of the allowance or the
3 ALL?

4 A. Yes. For the most part.

5 Q. And, what did you learn about that when you assumed the
6 role as national managing partner?

7 A. So, not being a banker I had seen our reports, PCAOB
8 reports that there was a high rate of deficiencies related to
9 inspections of financial institutions and a fair amount of
10 those comments related to the allowance for loan losses but
11 also other areas.

12 Q. And, at the time you assumed your role as national managing
13 partner, had KPMG received any Part II comments from the PCAOB?

14 A. So, the firm always receives Part II comments that are not
15 public.

16 Q. Had the firm received a Part II comment concerning its tone
17 at the top at the time you assumed your role as national
18 managing partner?

19 A. I don't remember if that was, I will say in-house, if we
20 had a report from the PCAOB when I arrived or if it came
21 shortly after I arrived.

22 Q. And, did it concern behavior before you arrived?

23 A. Yes. My view was I was not in my role for a, at all or a
24 substantial period during that report period, during that
25 inspection period.

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1 Q. I will ask you in a bit about what you did to remediate
2 that tone at the top comment but I just had a few more
3 questions about the inspection process.

4 What is your understanding of what a comment is?

5 A. So, if the PCAOB inspectors find a deficiency in or what
6 they believe is a deficiency in the level of audit work, they
7 will draft a comment that the engagement team would need to
8 address.

9 Q. And, is there a timeline for addressing a PCAOB comment?

10 A. So, yes.

11 Q. And what is your understanding of the timeline?

12 A. So, once the comment is received, we have 10 days to
13 respond to the comment. One of the issues is the comments can
14 come in at various times so sometimes you may get a comment.
15 If the inspection ended today maybe you would get the comment
16 in a few days, maybe you would get it in a week, it could be
17 even a couple of months. So, it is based on the date the
18 comment is actually received by the firm. You have 10 days to
19 respond.

20 Q. And then does the firm respond to the comment?

21 A. Yes.

22 Q. And how does it respond?

23 A. So, the comment comes in writing. The comment form
24 indicates background information, and then it has a section on
25 what the issue is so what is the deficiency in the audit work,

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1 and then the firm has a section of the comment form to agree or
2 disagree with the facts. So, sometimes the facts aren't quite
3 right and then discuss the issue and either agree or disagree
4 with the comment.

5 Q. So, there is a fact section and an analysis section,
6 correct?

7 A. That's a good way to put it.

8 Q. And after KPMG submits its response to the comment form,
9 what happens after that?

10 A. So, if it's an agree, nothing much happens until, I will
11 say, towards the end of the inspection cycle. The PCAOB will
12 inform us if they intend to put that comment in the Part I of
13 our report. If it is a disagree comment then there will be
14 further discussion.

15 Q. And if it's a disagree comment and there is further
16 discussion, is there similarly a resolution as to whether a
17 comment will appear in Part I of the inspection report?

18 A. Yes. So, the PCAOB, if we disagree, usually goes up to the
19 inspection team leaders and part of the disagree is why you
20 disagree with it and they will review and determine if they
21 are, I guess, convinced of your arguments on why you disagree,
22 or if they are not convinced and then if they're convinced, the
23 comment basically goes away. If they are not convinced then
24 the same process if they determine whether it should go in
25 Part I.

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1 Q. So, is it fair to say not all comments received by the firm
2 make it into Part I of the report?

3 A. Correct.

4 Q. Is it also fair to say that a comment that KPMG does not
5 object to may or may not make it into the report?

6 A. Correct.

7 Q. Does a comment making it into the report provide any
8 indication as to whether the issuer's financial statements are
9 inaccurate?

10 A. No.

11 Q. And, what's the difference between those two questions?

12 A. The inspections relate to the audit itself versus the
13 financial statements of the issuer.

14 Q. And then when is the timing of when KPMG receives an
15 inspection report in any given year?

16 A. So, if the inspection is for the period of, I will just
17 pick numbers to lay it out, if it is inspections done in the
18 summer/fall of 2014, it's for companies mainly that have a
19 12/31/13 year-end and that inspection report would probably be
20 issued sometime in the fall of 2015.

21 Q. So that would be a year and a half or longer after the
22 close of the fiscal year for the issuer?

23 A. Correct.

24 Q. And, I asked you a question about Part II. What's the
25 difference between Part I and Part II of the inspection report?

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1 A. So, Part I lists the issuers by an anonymous letter, issuer
2 A, B, C, etc. That is the comments that the PCAOB has written
3 about a particular engagement inspection and then Part II is
4 the overall views of the PCAOB on particular matters for a
5 firm, you mentioned tone at the top before, it could be a
6 particular audit areas of the firm's scoping, how it scopes out
7 what work is in and what work is out or estimates or other
8 topics.

9 Q. And is there a period of time for the firm to respond to a
10 potential Part II comment?

11 A. So, yes.

12 Q. And what is that period of time?

13 A. When the report is issued, so Part I becomes public, it is
14 posted to the PCAOB website, the firm receives a copy of the
15 entire report including the Part II and we have one year from
16 that date to respond to the Part II criticisms which is usually
17 a very lengthy document, and then the PCAOB would review that
18 document and determine if the remediation was sufficient in
19 their minds to remediate those deficiencies.

20 Q. Remediation meaning fix the problem?

21 A. Correct.

22 Q. Did you observe any trends with respect to the Big Four
23 accounting firms and the number of comments that they received
24 in Part I of PCAOB inspection reports?

25 A. Yes.

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1 Q. And what did you observe?

2 A. So, there were one firm that would have a high number, I
3 will say the most Part I comments and then it would hit a peak
4 and then come down, and then a couple of years later there was
5 another firm that had, hit a peak, the peak seemed to be 28,
6 and then would come down, then another firm would have a year
7 or two later hit the peak of 28 issuers in their Part I, and
8 then in 2014 KPMG became the firm that hit the peak of 28
9 issuers in Part I.

10 Q. In observations you just described, did Jay Hanson discuss
11 those with you in any meetings you had with him?

12 MS. ESTES: Objection. Hearsay.

13 MR. BOXER: For his state of mind, your Honor.

14 THE COURT: You can answer. Overruled.

15 THE WITNESS: Yes. He had indicated that he thought
16 the PCAOB had some people had a gotcha mentality.

17 BY MR. BOXER:

18 Q. And, PCAOB inspection -- withdrawn.

19 If a client's audit had received a comment in Part I
20 of an inspection report, was there any process or procedure
21 about discussing that fact with the client or the firm?

22 A. Yes.

23 Q. And, what was that?

24 A. The procedure the firm had would be that the client would
25 be informed that there is an item in our Part I, once again

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1 your issuer A or B or C, and let them know that that comment
2 was going to be in there, the typical or I guess the firm's
3 desired approach was that it was someone other than the lead
4 audit engagement partner who would present that to the audit
5 committee.

6 Q. And so you would tell the client which issuer they were in
7 the report?

8 A. Correct.

9 Q. And, did you participate in any discussions with firm
10 clients about the client appearing in Part I of a KPMG
11 inspection report?

12 A. Yes, I did.

13 Q. And, do you recall which issuers had that discussion with?

14 A. Yes. There is a number of my SEC reviews, I think Super
15 Value Costco, Foot Locker, Reynolds American. Maybe a few
16 others. And then I mentioned Darden and Rent-A-Center.

17 Q. Did they all receive a comment in Part I?

18 A. No. Some did.

19 Q. And for the ones that did, were you present for any
20 conversations about the comments with the audit committee of
21 the issuer?

22 A. Yes?

23 Q. And how often do you think that occurred where you were
24 present?

25 A. How many times I had been in those meetings?

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1 Q. Yes.

2 A. Probably half a dozen to a dozen times.

3 Q. And, what was your impression of the audit committee's
4 level of interest in the fact that the audit of the issuer had
5 received a comment in Part I?

6 MS. ESTES: Objection. Calls for speculation.

7 MR. BOXER: Fair enough.

8 THE COURT: Sustained.

9 MR. BOXER: I will try to rephrase it, your Honor.

10 THE COURT: Sustained.

11 BY MR. BOXER:

12 Q. Do you recall any specific conversations with an audit
13 committee or audit committee member where that issuer had a
14 comment from the audit appear in Part I?

15 A. Yes.

16 (Continued on next page)

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Middendorf - direct

1 Q. And could you tell us what you were told by the audit
2 committee member?

3 MS. ESTES: Objection.

4 THE COURT: Overruled.

5 A. So it happened multiple times but I'll just use one
6 example. The audit committee Chair, I had called him and said,
7 you know, the inspection that we had told them about the year
8 before that had happened, we just received our Part I report
9 and that company was in as issuer, once again, you know, letter
10 A, B, C, and I wanted to make sure that I informed him as the
11 audit committee Chair and then would present that at the entire
12 audit committee -- the next audit committee meeting and --

13 Q. What did the Chair say to you?

14 A. I remember his response being, "I don't care and so be
15 brief."

16 Q. And was that typical of the responses you heard from audit
17 committee chairs in similar situations?

18 A. Yes.

19 Q. I want to ask you a few questions about your reports, you
20 direct reports, and how DPP was structured.

21 When you arrived in June of 2014, what was the
22 structuring of DPP?

23 A. So my predecessor had various individuals who reported to
24 him that there was an Audit Group, an accounting group, a SEC
25 practice advisory group, inspections, and an audit quality

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Middendorf - direct

1 process monitoring group.

2 Q. And who was the head of the accounting group when you
3 arrived at DPP?

4 A. Mark Beilstein.

5 Q. And was there a Chief Accountant that reported to you at
6 that time?

7 A. He did not have the name or the title Chief Accountant,
8 but, yes, he was the leader of DPP.

9 Q. And who was that?

10 A. Glenn Davison.

11 Q. And was there a leader of audit?

12 A. Yes.

13 Q. Who was that?

14 A. George Hermann.

15 Q. And Mr. Beilstein, what were his duties and
16 responsibilities?

17 A. So he was head of the accounting department, so focused on
18 matters of accounting. So there was a new standard coming out
19 right when I got to my role, there was a new revenue
20 recognition standard the Financial Accounting Standards Board
21 had issued that would be implemented over the next few years.
22 So, that would be something his group would work on to prepare
23 guidance for engagement teams to prepare publications,
24 basically a book, that we would give out to clients that this
25 is guidance for them on how to do this. You know, anything

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1 accounting-related we had people who sat on the emerging issues
2 task force of the Financial Accounting Standards Board, etc.,
3 so all items accounting.

4 Q. You mentioned the SEC Practice Advisory Group. Who headed
5 that when you started back at DPP?

6 A. It was co-led by John Ellison and Carmen Bailey.

7 Q. And what kind of work did that group perform?

8 A. So in general, that is the I'll call it the technical call
9 center. If you are an engagement team, an engagement partner,
10 the engagement manager on the audit side that has a technical
11 inquiry, you call that group. And that group also had
12 responsibility for SEC matters, so clients that maybe had a
13 comment letter from the Division of Corporation Finance, maybe
14 had an issue from Enforcement, those matters would all go up
15 through that group.

16 Q. And who was Craig Crawford?

17 A. Craig Crawford was the partner who was in charge of a group
18 called the audit process -- Audit Quality Process Monitoring
19 Group.

20 Q. That was another group that reported to you?

21 A. Correct.

22 Q. And I assume they monitored audit quality, as the name
23 suggests?

24 A. Yes. I'd say it was maybe the early stages of the root
25 cause analysis process.

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Middendorf - direct

1 Q. What is a root cause analysis?

2 A. A root cause analysis is to say here are my problems, my
3 deficiencies, and what is the actual root cause that's causing
4 that deficiency. You may just think it's the engagement team
5 wasn't appropriately staffed or the engagement team wasn't
6 knowledgeable, but rather than guess what the root cause of the
7 problem was, it was to do analysis to determine what's really
8 causing the deficiency, causing a particular deficiency.

9 Q. And was there an Inspections Group that reported to you?

10 A. Yes.

11 Q. And who was the head of the Inspection Group?

12 A. Tom Whittle.

13 Q. And do the regional practice group heads also report to
14 you?

15 A. Yes. So --

16 Q. Who were they?

17 A. KPMG splits the country into an East and West Region just
18 for managing the audit practice. Laurie Mullen was the West
19 Region professional practice partner, and Kevin O'Hara was the
20 East Region professional practice partner.

21 Q. And how many practice groups or offices in total did
22 Ms. Mullen and Mr. O'Hara oversee?

23 A. So within the regions, the firm broke down the country into
24 18 business units. Ten of those reported up to Ms. Mullen and
25 eight reported to Mr. O'Hara.

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Middendorf - direct

1 Q. And Ms. Mullen and Mr. O'Hara reported to you, correct?

2 A. Yes, they were my direct reports, two of my direct reports.

3 Q. And then at some point you restructured DPP a little bit,
4 is that right?

5 A. Yes.

6 Q. Could you explain what the restructure was?

7 A. I'd say not significant changes but important changes, and
8 it was I had probably been in my role I'll say around a year.
9 So --

10 Q. What changes did you institute?

11 MS. ESTES: Objection, your Honor, to the
12 interrupting.

13 THE COURT: That is fine. Go ahead.

14 A. So originally I mentioned Mr. Glenn Davison was the head of
15 DPP directly below me. The Audit Group, the Accounting Group
16 and the Practice Advisory SEC group all reported to him. I
17 felt that because of the audit quality issues we were having
18 and numerous initiatives we were putting in place, Mr. Hermann
19 should report directly to me. So, we made that change. And
20 then Mr. Davison, who was very close to the firm's mandatory
21 retirement age for partners, I changed the individual who was
22 in that role. Mr. Davison stayed on maybe for another year or
23 two, but Jeff Jones became the head of the Accounting and
24 Practice Advisory Groups, and I changed his title to Chief
25 Accountant. And I forgot to mention Mr. Hermann became -- his

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1 title became Chief Auditor.

2 Q. And did the other groups that you previously mentioned, did
3 they still report to you?

4 A. Yes. I made a change. Mr.Crawford, who was the head of
5 the Audit Process -- Audit Quality Process Monitoring Group was
6 also nearing retirement. I asked an individual named Steve
7 Georgian to join that group and ultimately take over, and I
8 changed that from reporting directly to me to reporting to
9 George Hermann, the chief auditor.

10 Q. So when you started in your role at DPP, did you have
11 certain goals in mind?

12 A. Yes.

13 Q. And what were they?

14 A. I'd say one was the National Office. DPP had historically
15 been viewed as the, you know, premier part of the firm to
16 advance your career, you know, learn different industries,
17 become a technical expert on both accounting and auditing. And
18 over the years, I'd say maybe five or so, ten years before I
19 got to my role, that had kind of slipped, that it was
20 recruiting resources became very hard because folks in the
21 business, the business units, wanted to keep their high quality
22 people to do the audits in the field and gain new clients, etc.

23 Q. So you wanted to change that?

24 A. I wanted to change that.

25 Q. Anything else you set for yourself as goals?

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1 A. Yeah. So I came into my role with -- you know, we were
2 trending, as I mentioned before, the firm that was now having
3 the highest number of Part I issuers and focused on how do we
4 improve audit quality, and improving audit quality is the goal
5 but the, you know, one of the outputs of that would be to help
6 reduce the inspection number of Part I issuers.

7 Q. And did you institute and support various programs to
8 improve audit quality at KPMG?

9 A. I did, but first I needed to increase the level of
10 resources in my group.

11 Q. And were you able to accomplish that?

12 A. Yes. It wasn't easy. I'll just use an example. When I
13 got to my role, the National Office has a rotational philosophy
14 I mentioned when I was -- did that in the late 1990s, so people
15 come in for a few years. We try to help groom them and then
16 rotate out. My goal was -- well, I guess I had talked to all
17 of my direct reports. We need more resources to accomplish the
18 things we wanted to accomplish. When I got to my role, only
19 about 15 people came in on that rotational basis. And after
20 talking to all of my direct reports, we were looking to recruit
21 about 90 people over my first year in that role, which would be
22 a huge increase from the 15 we had just gotten, and, you know,
23 we needed to focus on how we were going to recruit that many
24 resources.

25 Q. I would like to show you what's marked as Exhibit M306.

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1 Do you recognize that document?

2 A. Yes.

3 Q. And what do you recognize it to be?

4 A. It is a graphic that we used as part of a presentation to
5 both the PCAOB and to our inspection team. We had monthly
6 meetings with the PCAOB inspection team, and then we also
7 presented this to the KPMG board.

8 Q. And does M306 reflect various initiatives that were
9 instituted from the time you became national managing partner?

10 A. Yes.

11 MR. BOXER: I offer it, your Honor.

12 MS. ESTES: No objection.

13 THE COURT: M306 is received.

14 (Defendant's Exhibit M306 received in evidence)

15 BY MR. BOXER:

16 Q. Could you walk the jury through first generally how it is
17 structured without going through each particular circle? What
18 is depicted in M306?

19 A. Yeah. So it depicts numerous audit quality initiatives
20 that we had put in place and were putting in place. And if you
21 see on the I'll say kind of the bottom left side, it has an
22 arrow that talks about some things have an indirect impact on
23 audit quality and some things have a direct impact. So if you
24 look at the first kind of maybe the infield of the baseball
25 diamond here, specific issues that were coming up as audit

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1 quality issues, whether in external inspections or internal
2 inspections or estimates, the internal control over financial
3 reporting as "ICOFR." "ALL" being the allowance for loan
4 losses. Supervision and review, professional skepticism, etc.,
5 so those were at the engagement team level.

6 If you go up, the next blue band is a lot of our audit
7 quality monitoring programs that we had put in place, which
8 would be to supplement the engagement teams having some kind of
9 monitoring program. And if you get to the next band out that
10 is kind of a teal color, it says "Process Improvement." Those
11 are things on a much larger scale that maybe aren't direct
12 impacts to audit quality but have indirect impact.

13 So "Resource Management Scheduling," do we have the
14 right resources that are being scheduled on audit engagements?

15 Root cause analysis, we mentioned a little bit ago of
16 we had to change the leadership of that group. We hired
17 someone from the PCAOB to be in that group. We hired a
18 consultant to help us develop a more robust root cause analysis
19 process, you know, trained up the people, we added resources in
20 that area. So that's -- I haven't gone through everything but
21 that's kind of an overview of what it is.

22 Q. The second level, the monitoring programs, is it fair to
23 conclude from M306 that there were eight separate monitoring
24 programs that were instituted at DPP after you became national
25 managing partner?

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1 A. Yes.

2 MR. BOXER: Your Honor, I am going to move on to the
3 PCAOB now, and it is a convenient time to break, if that is OK,
4 or I can keep going if you would like.

5 THE COURT: Yes. It is almost -- it is about four
6 minutes to 5 so why don't we break.

7 Folks, I am just going to remind you to leave your
8 notepads on your chairs. You are not yet deliberating so don't
9 discuss the case.

10 We will continue, as we have in the past, at 9:30
11 tomorrow morning. We will have coffee by around 9.

12 Have a good night and we'll see you tomorrow morning.

13 (Continued on next page)

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1 (Jury not present)

2 THE COURT: You may be seated.

3 MR. BOXER: Your Honor, as far as scheduling, I do
4 have a fair amount more left to go. I'm turning to more of the
5 evidence, the emails and things like that that are in evidence.
6 So I think it could be a half a day tomorrow. I am going to
7 look at it tonight and try to make it, what usually happens,
8 which is make it shorter, but as far as planning for the
9 government, I think for sure it will pass the first break.
10 Maybe I will be proven wrong but I just wanted to put them on
11 notice.

12 THE COURT: All right.

13 So we talked about a charge conference tonight, but it
14 sounds like I'm absorbing the letters we received earlier today
15 and the government wants to spend some time with it as well.
16 So, maybe we should put that off to perhaps tomorrow and see
17 where things stand tomorrow.

18 MS. KRAMER: That makes sense, your Honor.

19 THE COURT: All right. Anything else anybody want to
20 discuss tonight?

21 MS. KRAMER: I would like to discuss the conference
22 call records that defendant Wada intends to put in whether by
23 certification or custodial witness.

24 They are not relevant and whatever probative value
25 they have is substantially outweighed by the danger of her

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1 confusion. The records reflect conference calls on the KPMG
2 conference call system on March 28, 2016 at and around the time
3 that the government alleges Cindy Holder was on the phone with
4 Jeff Wada getting the March 2016 list. The number that dialed
5 into the calls that the defense wants to put before the jury is
6 a phone number that was not assigned to Cindy Holder until four
7 months later. So, it is as relevant as picking any other desk
8 number that was used at that day at the same time as that call
9 with Jeff Wada and putting it in front of the jury and trying
10 to argue that Holder wasn't on the phone with Wada because,
11 look, another call had a number. That number had no connection
12 to her whatsoever until four months later.

13 I think there was some confusion about this because it
14 was in her email folders at some point, and so I think this
15 started with a good faith belief that perhaps it was her
16 number. But it has been clarified. We've produced an email
17 from KPMG that we recently received demonstrating that she
18 didn't have that number until July. So, it has no probative
19 value whatsoever that someone else at KPMG was on the call.

20 KPMG has told counsel for Wada that. We have produced
21 the email. And so if they put this in, we will put in a
22 rebuttal witness to prove that she wasn't assigned this number,
23 but it just shouldn't happen in the first place under 403.

24 THE COURT: Is this the same number that is referenced
25 in the email where she says call me at this number, or this is

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1 something else?

2 MS. KRAMER: No, your Honor, this is something else.

3 So the day of the March 28th call, she did not have a
4 New York desk number assigned by KPMG. That didn't happen
5 until four months later. So, you know, the email that she
6 sends to someone two hours after the Wada call saying call me
7 on this number, that is not the subject of the conference call
8 records they want to put in. They want to put in a conference
9 record showing that someone using, just as an example, the
10 number ending in 1234 had a conference call at the same time,
11 and it happens to be that that number was assigned to her four
12 months later but it was not assigned to her on March 28th. It
13 is just -- it is misleading to suggest otherwise.

14 And so, you know, there is a little bit of a trial
15 within a trial that's going to happen as a result of this, and
16 there is just -- there is no relevance and no probative value.
17 And what arguments they want to make from it are misleading
18 based on the evidence that they've seen and representations
19 that have been made to them and so we think it should be
20 precluded.

21 MR. WEDDLE: Your Honor, the government marked as a
22 government exhibit I believe it was Exhibit 1304, which was a
23 spreadsheet of conference call dates. In that spreadsheet,
24 there is a phone number referenced which ends in 1417. The
25 spreadsheet says that that number belongs to Cindy Holder. The

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Middendorf - direct

1 government also produced in discovery a global directory for
2 KPMG. It was the subject of some argument at the sidebar one
3 day, your Honor may recall. It's a document that comes in a
4 binder that is about five inches thick, I think. And that
5 global directory lists the number 1417 as Cindy Holder's
6 number, and it lists a different person as the owner of the
7 phone number 2251 -- the phone number ending in 2251. The
8 government has contended, and they have put into their summary
9 chart, that the number 2251 is a number that Cindy Holder was
10 using on that particular day. On that particular day, there is
11 a phone call to Jeff Wada from the number 2251.

12 There is -- in my view, so from my perspective, I've
13 got two business records of KPMG associating the number 1417
14 with Cindy Holder, with no ambiguity about the date range or
15 anything like that.

16 There are extensive business records of KPMG that said
17 1417 is Cindy Holder's phone number. There are a number of
18 emails in evidence in which Cindy Holder's signature line for
19 her email said that her number is 1417. There has been
20 testimony that KPMG also has the ability for people to borrow
21 phone numbers, this hoteling concept, and testimony that the
22 number 2251 was in the hoteling system at a particular time.
23 But contrary to that evidence, your Honor, is this global
24 directory which has 2251 associated with a particular person's
25 name.

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1 So -- and I should add that yesterday, for the first
2 time, I saw a document produced by the government in discovery,
3 which was an email from July 2016 saying that the number 1417
4 was assigned to Cindy Holder, and the email I think has in it
5 either as recipients or senders the hoteling system.

6 So I have had discussions with KPMG's counsel. I may
7 be misremembering, but I've heard different timeframes in terms
8 of when the number was assigned to her, some different
9 confusion about why is it that Cindy Holder's name appears in
10 two other business records, one of which was marked as a
11 Government Exhibit in the case. So it seems to me that there
12 is a lot of confusion and that -- or to put it a different way,
13 there are bits of information and evidence pointing in
14 different directions. And when there are bits of information
15 and evidence pointing in different directions, we have a trial.

16 So we intend to present our evidence. If they have a
17 rebuttal case to present, they could present their rebuttal
18 case. The first time any disclosure has been made about their
19 purported rebuttal case was yesterday, when I got this email
20 produced in discovery that purports to date the assignment of
21 this phone number. So it's not the situation where -- this
22 isn't a situation where all of the information points in a
23 particular direction. This is a situation where information
24 points in different directions, and both sides should be able
25 to present their argument.

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Middendorf - direct

1 THE COURT: Tell me exactly what you are trying to get
2 in.

3 MR. WEDDLE: So what we are planning to present in the
4 form of a 902.13 certification from Verizon is specific
5 information about three conference calls. And the conference
6 calls were dialed into by the 1417 phone number, the one that I
7 have told you is listed in KPMG business records, including
8 Government Exhibit 1304, as Cynthia Holder's number. For a
9 period of time it overlaps with the phone call from 2251 that
10 the government contends is Cindy Holder's phone call to Jeff
11 Wada. So the phone calls that are in the conference call data,
12 there is one at 9:54 a.m. There is one at 12:28 a.m.

13 THE COURT: On which date?

14 MR. WEDDLE: Sorry. On March 28, 2016, so a key date.
15 Obviously March 28, 2016, it is a date that the government
16 contends KPMG obtained the 2016 inspection list.

17 THE COURT: So the information you have is that the
18 conference call, the 1417 number called into on that date.

19 MR. WEDDLE: Correct. And the three conference calls
20 on that date the 1417 participated in, and the one that I think
21 is the most important one is the one where 1417 dialed into a
22 conference call at 12:28 p.m. for 18 minutes.

23 So 12:28 p.m. for 18 minutes. If I can do math in my
24 head well enough for this audience, we'll see, but I think that
25 that takes us to 12:46 p.m. If we assume that that's all in

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1 New York time, that's a four-minute overlap with the call that
2 the government has put into its summary chart as taking place
3 between 12:42 p.m. and 1:33 p.m. from the number ending in 2251
4 to Jeff Wada. That is a 51-minute call. So --

5 THE COURT: But what is the evidence you have that the
6 1417 number was used by Cindy Holder on 3/28?

7 MR. WEDDLE: Well, I don't have any evidence from
8 3/28, your Honor. The government also doesn't have evidence
9 that's exactly contemporaneous with the attribution that
10 they're trying to make. So they have an email from a couple of
11 hours later, on March 28th, by Cindy Holder telling someone to
12 call her at that number.

13 THE COURT: At 2251?

14 MR. WEDDLE: No, at -- right, at 2251. That's right.

15 And so the -- I mean, I think that it's fair argument.
16 They have a different time. They have a document with a
17 different time on it from Cindy Holder saying call me at this
18 number. They've also put in evidence that the number is not
19 assigned -- 2251 is not assigned to Cindy Holder at any time.
20 We have a phone number that is assigned to Cindy Holder at some
21 time. There seems to be a dispute about when that is. It is a
22 phone number that's permanently assigned to her such that it
23 appears in her signature line of her email.

24 And I think that -- look, this may not be a great
25 argument, your Honor, but I don't think it has to be a great

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1 argument in order for us to try the case according to the
2 evidence and to put the government to its proof. But in every
3 organization that I've worked in, the organization has not
4 found it to be useful to reassign phone numbers to different
5 people at different times, if they can help it. KPMG, I
6 understand, has the capability of assigning a phone number to a
7 KPMG employee and having that phone number ring at whichever
8 physical phone a KPMG employee may be working at on a
9 particular day. They also have, you know, what I think of as
10 desk offices or hoteling numbers because their people travel
11 all the time. I travel a lot. In my law firm we have guest
12 offices. Sometimes I just use a number. Sometimes I walk into
13 an empty office and I say call me at this desk phone.

14 So the fact that Cindy Holder says call me at 2251 a
15 couple of hours after a key phone call I think is -- there is
16 room for argument there that that's -- this is weak evidence.
17 I mean, the point that we're making is this email from a couple
18 of hours later is very weak evidence that Cindy Holder is this
19 caller.

20 And it's a critical fact because if the government
21 doesn't believe beyond a reasonable doubt that Cindy Holder is
22 that caller and if the government doesn't believe -- I mean, if
23 the jury doesn't believe beyond a reasonable doubt that they
24 can infer what the content of that call was from 2251, a number
25 not assigned to Cindy Holder, there is no -- there is no case

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1 on the 2016 list. There are other defects as well, your Honor,
2 but I think this is a situation where we are entitled to test
3 the government's proof. I don't think they should be seeking
4 to just preclude us from admitting relevant evidence.

5 THE COURT: When does this signature line say 1417?
6 Do you know what dates that comes up?

7 MR. WEDDLE: I know that the ones in evidence, I think
8 the earliest one is October 2016, so after the timeframe. And
9 after the timeframe that the government contends is the date
10 assigned. They have -- you know, they have produced a document
11 yesterday for the first time which says that the assignment
12 occurred in July 2016.

13 THE COURT: Is there evidence that it was assigned to
14 her two months later? Because if that is the case, I think
15 that undermines any probative value to this number.

16 MR. WEDDLE: I'm sorry. Evidence --

17 THE COURT: Well, the spreadsheet itself doesn't give
18 any date information. It just says at some point it was
19 assigned to her. Is that right?

20 MR. WEDDLE: Yes, that's right.

21 THE COURT: There is no update?

22 MR. WEDDLE: There is a word "Cindy Holder" next to
23 that phone number.

24 THE COURT: There is no information about when it was
25 assigned?

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1 MR. WEDDLE: But it's a spreadsheet that covers a long
2 period of time, your Honor. So this spreadsheet that's marked
3 as Government Exhibit 1304 -- I hope I'm not getting that
4 number wrong -- I think it is 1304, it is a spreadsheet, and it
5 contains, I didn't count them, thousands of conference calls.
6 And on the conference call that I'm talking about on
7 March 28th, there is a line, Government Exhibit 1304, for this
8 conference call of 18 minutes. And one of the columns says --
9 I think it says Cynthia Holder. I don't know if it has her
10 middle name there. But it's there in the line on the day and
11 time as the conference call that we're seeking to admit into
12 evidence. That is something that was produced by KPMG to the
13 government. Presumably KPMG was taking this criminal
14 investigation of KPMG and its personnel seriously. They
15 produced that spreadsheet to the government as part of its
16 cooperation with the government's investigation, and the
17 government produced it to us as a marked government trial
18 exhibit.

19 THE COURT: I don't care about that. Obviously, the
20 system just assigned her name to that number at some point. I
21 mean, I don't know why you say that the 2251 email from two
22 hours later is not strong evidence. It's very strong evidence.

23 MR. WEDDLE: I didn't say it is not strong evidence --

24 THE COURT: It is evidence two hours later. She said
25 call me at this number.

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1 MR. WEDDLE: All I said, your Honor, is I am entitled
2 to test the evidence. I don't think the government is entitled
3 to preclude us from testing their evidence. It's evidence.
4 The jury may think it is strong evidence. They may think that
5 we're making a weak argument. But it's an argument, your
6 Honor, and I think we are entitled to put them to their proof.
7 They have the burden of proving these facts beyond a reasonable
8 doubt. KPMG produced a document that has associated with this
9 very call on March 28th her name.

10 THE COURT: Ms. Kramer.

11 MS. KRAMER: Your Honor, they're certainly entitled to
12 argue to the jury that two hours later an email saying call me
13 at this number does not mean that she was using the number two
14 hours earlier. Fine. That does not in any way, shape or form
15 make the fact that someone else using a phone number that would
16 later be assigned to her had a call on March 28th. There has
17 been no connection --

18 THE COURT: He's saying the jury might reasonably
19 conclude that that was her number.

20 MS. KRAMER: I'm sorry, that which was her number,
21 your Honor?

22 THE COURT: That she was using the 1417 number on
23 3/28.

24 MS. KRAMER: That is not a reasonable conclusion, and
25 it shouldn't be put before the jury because we have evidence

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1 and a witness who will say that that was not assigned to her
2 until July 2016.

3 THE COURT: Tell me about that evidence.

4 MS. KRAMER: Certainly, your Honor. So we have email
5 that we did produce yesterday because, you know, as your Honor
6 knows from when defense counsel tried to put in this
7 spreadsheet, we've been pursuing, you know, their argument
8 based on this document that we have repeatedly explained was
9 compiled for litigation and has no dates on it whatsoever. So
10 we produced it to them. It is an email that I think we can put
11 up for your Honor.

12 (Pause)

13 It is a request that Cindy Holder needs a New York
14 number and then the New York number is assigned.

15 So looking at the bottom, your Honor, July 14, 2016,
16 three-and-a-half months after the phone call that is at issue
17 here: "Can I please request a New York number for Cindy
18 Holder?" And then this is the response. July 22,
19 three-and-a-half months after call at issue, that she is
20 assigned the 1417 number. There is not a single email footer
21 with her using the 1417 number in March 2016, because she was
22 no more using that number than I was. It was not assigned to
23 her. It has no connection to her whatsoever. And it's --

24 THE COURT: I'm not seeing the 1417.

25 MS. KRAMER: The 7 goes to the next line, your Honor,

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1 in the top email. So it is 212 -- can you highlight it
2 please -- 212-954-1417.

3 THE COURT: Got it, 212-954-1417.

4 MS. KRAMER: We have represented to counsel, KPMG
5 counsel has represented, and is in the courtroom and can
6 certainly provide more information if your Honor needs it,
7 repeatedly, repeatedly, that the spreadsheet they're relying on
8 means nothing. It has information that was in the system
9 somewhere at the time that it was compiled for us in the course
10 of our investigation. We have repeatedly made that clear to
11 them. We have followed up and found this document to show
12 them. The fact that this is still being pursued just blows my
13 mind, and this is evidence that should not be put before the
14 jury because it has no relevance whatsoever to what happened
15 four months before she was assigned this number.

16 THE COURT: I don't see how it's anything other than
17 misleading or at best wasting time, confusing the issue for the
18 jury, given this. I mean, unless you think there is something
19 unbelievable about this?

20 MR. WEDDLE: Well, I don't think the document speaks
21 for itself. The first time I ever saw this document was
22 yesterday. You know, the document is sent to New York hoteling
23 services. It looks like it is probably a permanent assignment,
24 but, you know, I don't think that that's beyond all possible
25 doubt. And I think we're talking about five minutes of trial

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1 time, your Honor. I think that what we have here is a conflict
2 in the evidence.

3 THE COURT: I don't think there is any evidence that I
4 have heard of that Cindy Holder could possibly have been using
5 the 1417 number on 3/28, as opposed to two months later after
6 that, given what's been represented.

7 MR. WEDDLE: I don't think that there is -- no one has
8 nailed down who was assigned 2251 on March 28th.

9 THE COURT: Right. But you have, even better than
10 that, you have her saying call me at this number. That's
11 better than any spreadsheet.

12 MR. WEDDLE: But -- well, your Honor --

13 THE COURT: I mean, I'm speaking freely, I realize. I
14 don't mean to say it is dispositive. I'm just saying that that
15 is pretty strong evidence to support an inference that two
16 hours later she was at that number.

17 MR. WEDDLE: That's my point, your Honor. I don't
18 think that anything that we've heard is dispositive, so we are
19 entitled to test the evidence. It doesn't have to be -- it
20 doesn't have to be the strongest argument in your Honor's mind
21 for it to be something that we are entitled to argue.

22 And the evidence that they've put in about the 2251
23 number is that it is a temporarily assigned number. There has
24 been no evidence of who it was assigned to on March 28th at
25 all. And so at a moment in time on March 28th, Cindy Holder

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1 says call me at this number. I don't think that it is
2 necessary for the jury to infer from that that it was assigned
3 to her on that day. They could infer that it was assigned to
4 her on that day from that information, or they could infer that
5 she wandered into another office. Every other phone call that
6 she made that day, as far as I know, is from her cell phone.

7 So there is this one phone call and there is a dearth
8 of information about it. And the government wants to say it's
9 clear as day that this has to be Cindy Holder. There are all
10 sorts of things that could be going on. That and, you know,
11 and then after that debate, there is a major question, and I
12 think a failure of proof, about what the content of the phone
13 call was. Even if they could establish that this was Cindy
14 Holder's phone number --

15 THE COURT: That is a whole different issue.

16 MR. WEDDLE: I think what we are talking about here is
17 five minutes of trial time. I don't think that they get to
18 preclude us from raising -- from pressing them, even if they
19 think it is an incredibly weak argument or a weak inference.
20 And even if your Honor agrees it is a weak inference from the
21 emails that are in evidence, that this number was assigned to
22 her at a different time from what this email says in July 2016,
23 I don't think that there is a -- I don't think that it is
24 misleading. I think it may be -- maybe your Honor thinks it is
25 a weak argument, but I think it is one that we are entitled to

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1 put in.

2 THE COURT: Just to go back for a second. What
3 exactly you want to put in is three lines from -- this is the
4 Verizon information?

5 MR. WEDDLE: Right. Exactly right, your Honor.

6 THE COURT: And what exactly does it purport to show?

7 MR. WEDDLE: The Verizon information --

8 THE COURT: Oh, that is the three conference calls.
9 Sorry.

10 MR. WEDDLE: It just says three conference calls. It
11 just has the phone number. When we started this pursuant on
12 the defense side, we were working with a marked government
13 exhibit that had Cynthia Holder's name in it. Counsel is
14 correct that we had conversations both with the prosecution and
15 with KPMG's lawyers about these documents, and the
16 understanding has changed over time. I'm not saying that
17 anyone misstated anything at any point in time, but what
18 appeared to us to be a business record of KPMG when we looked
19 at it we were later told is not, it is a compilation, it is
20 made for litigation. And then we started drilling down into
21 what are the underlying documents.

22 And so we have ended up where we are, which is with a
23 request, you know, to Verizon for these three calls. And the
24 association with the 1417 number without the name Cindy Holder,
25 because Verizon doesn't have that in their system -- that's

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1 something that came from Government Exhibit 1304 -- and we're
2 continuing to pursue it, I mean, in all of our extra free time
3 during this trial. And then yesterday we get an email from the
4 government that of course doesn't answer the question, but,
5 frankly, the way that this thing is going, I think who knows
6 how it is going to evolve. And we're talking about three
7 conference calls. They can put in their email. Maybe, you
8 know, maybe the argument disappears.

9 THE COURT: Well, I think it is a stretch but I don't
10 know that I can preclude --

11 MS. KRAMER: Your Honor, may I just say one more
12 thing?

13 THE COURT: Sure, you can try again.

14 MS. KRAMER: The defense is not precluded from making
15 all of the arguments that are available to them from the time
16 difference between the call between the 2251 number and Jeff
17 Wada on March 28th and the time when Cindy Holder sent the
18 email to her immediate supervisor two hours later saying call
19 me at this number. That is the thrust of their argument that
20 Mr. Weddle has repeatedly referred to. He wants to test our
21 evidence. And that is fine, and we're not seeking to preclude
22 arguments about that time difference.

23 This is now a bridge too far, because what they're
24 doing is taking evidence that they know in good faith does not
25 say what they originally thought it said. In good faith, they

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1 started pursuing this, as they said, not realizing the sort of
2 nature of the document they were looking at. But now everybody
3 is on equal footing and understands that Cindy Holder was not
4 assigned the 1417 number. So, you know, it is not just five
5 minutes of the defense case and putting in the three conference
6 calls. We're going to call, you know, one or two witnesses
7 from KPMG to testify about that email, that Cindy Holder was
8 assigned to it. We're going to go back to our office now and
9 figure out is there a witness who can give testimony that the
10 1417 number was assigned to someone else on March 28, 2016, to
11 clean up the confusion that this misleading evidence will
12 create for the jury.

13 So it's not just a waste of time, which is not
14 insignificant. It's also confusion for the jury. And it is
15 irrelevant what number participated in a conference call when
16 that number was not assigned to Cindy Holder until far later.
17 They're the proponent of this evidence, and they've proffered
18 nothing whatsoever that connects the 1417 number to Cindy
19 Holder until July of 2016.

20 MR. WEDDLE: Could I just add one thing, your Honor?

21 THE COURT: Yes.

22 MR. WEDDLE: So the phrase "good faith" has been
23 thrown about. I think that given the way that the information
24 that we have has evolved over time and given the fact that the
25 government itself is saying that it is going to need two

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1 witnesses to establish the facts that they say is
2 incontrovertible from the email, which I say is not
3 self-explanatory, I think is -- I mean, that's more than enough
4 good faith basis. I think that, you know, we started this with
5 some business records from KPMG, and, you know, KPMG I think is
6 not in the business of typing information into computer systems
7 that is inaccurate.

8 THE COURT: Well, the fact that there is that
9 information, that might have the given them a good faith basis
10 that no longer exists.

11 MR. WEDDLE: But my point is -- I'm sorry, I don't
12 mean to cut you off.

13 THE COURT: No. Go ahead. Make your point.

14 MR. WEDDLE: My point is we've seen this entry in KPMG
15 records, and now we're told, oh, those records are wrong,
16 here's the right record. I don't know who that 1417 was
17 assigned to. If they say it wasn't assigned to Cindy Holder
18 before July 2016, who was it assigned to, then? I mean, you
19 know, so. And the fact that they need to call a couple of
20 witnesses to testify about something that they say is
21 incontrovertible I think shows that it demonstrates quite
22 clearly that it is not incontrovertible. This is not a simple
23 question. And we're just pulling on a thread that seems to
24 keep unraveling.

25 MS. MERMELSTEIN: Your Honor, I'm sorry to keep

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1 beating this horse. But Mr. Weddle is the proponent of this
2 evidence, and he has not met the basic threshold of showing
3 that it is relevant, which is, in fairness, an incredibly low
4 threshold and he has not met it. You cannot establish that I
5 was on a conference call yesterday by showing what my telephone
6 extension was when I worked at Simpson Thacher 12 years ago.
7 It is not relevant. You have to first show some connection
8 that the person was using the phone number at that time.

9 The fact that KPMG has a record that shows that at
10 some point in time that was used, that was her number, and
11 there has been definitive evidence that it was not at this
12 point in time makes this evidence not relevant under the rules
13 of evidence. And it is going to be wildly confusing for the
14 jury and a complete sideshow.

15 And in the absence of some evidence that Cindy Holder
16 was using a number four months before it was assigned to her,
17 the evidence is inadmissible on a relevance basis, period.

18 The spreadsheet that Mr. Weddle has continued to refer
19 to is not a business record and it does not show anything. We
20 understand how defense counsel sort of thought this was an
21 avenue worth pursuing, but it is now clear that that simply has
22 no basis in fact. And relevance is the preliminary threshold.
23 How much evidence the government would have to bring to
24 disprove this nonsense theory is not the point --

25 THE COURT: OK. OK.

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1 I think information about the three conference calls
2 on 3/28 from the 1417 number is information that is not
3 relevant without some additional foundation. I mean, this is
4 Rule 104: When the relevance of evidence depends on whether a
5 fact exists, proof must be introduced sufficient to support a
6 finding that the fact does exist.

7 And I don't think this is a situation where there is
8 any -- given what's on the table, what we all know, I don't
9 think there is a sufficient foundation for the relevance of
10 those conference calls from the 1417 number on 3/28. So
11 without an additional proffer, I am going to sustain the
12 objection to it.

13 What else?

14 (Pause)

15 Did you have -- you have text messages that you want
16 to get in, or are they emails?

17 MR. WEDDLE: Yes, your Honor. We do have a series of
18 text messages that we plan to offer.

19 As to some of them, the government has indicated a
20 hearsay objection.

21 So, just to orient the Court, your Honor, during the
22 testimony of Enrique Santos -- he testified about Cindy
23 Holder's cell phone -- we authenticated but did not offer a
24 fairly comprehensive set of Cindy Holder chats. We've marked
25 it as Government Exhibit 1013. And that's the one where at the

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1 end Ms. Jason was doing the cross-examination of Mr. Santos,
2 and he explained that at the end of this particular report
3 there is what's known as a timeline of the chats which shows in
4 chronological order the various different conversations she was
5 having, you know, in overlapping times.

6 We've marked as defense exhibits a number of excerpts
7 from 10/13. And we've been in discussion with the prosecution
8 about these, and I think I have some of their objections and I
9 think some of them I'm not sure whether or not they object. It
10 may be my fault for giving them the excerpts late, your Honor.

11 But I'll just -- this is mostly from Ms. Estes. But
12 of the ones that we've marked, I think we are going to skip and
13 not offer A, B or C.

14 Then we have 1013D, which I believe the government
15 does not object to.

16 And then 1013E, which I'm not sure about.

17 And we can display this on the screen, your Honor, or
18 I don't know what would be easiest for you.

19 (Pause)

20 THE COURT: Do I have these or not?

21 MR. WEDDLE: Let me check.

22 THE COURT: I think I just have 1013.

23 MR. WEDDLE: Sorry, your Honor. Maybe I have a set.

24 (Pause)

25 Your Honor, we have them in folders. I can hand you a

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1 stack of folders. It is more than one copy per exhibit, but
2 that is the way it was produced. I apologize, I didn't have a
3 binder set up for you.

4 So this is 1013E. I don't know if there is a
5 objection to this. What we've done here, your Honor, to
6 explain is we've taken some additional chats beyond what the
7 government has marked in some instances. So the blue
8 highlighted portion is marked as a government exhibit that's
9 already been admitted. And then there is some additional bits,
10 some of them are in plain white and some of them are in other
11 colors, to show other conversations that were taking place at
12 around the same time.

13 This one, for example, I think -- well, I think all of
14 the things that I'm talking about, your Honor, all of these
15 chats are admissible not for their truth, for a number of
16 reasons. They show the character of the conversations between
17 Mr. Wada and Ms. Holder. They show the context of different
18 statements that are being made by both of them. And so for
19 that -- on that basis alone, they are admissible.

20 There are some chats that look like they are
21 assertions of fact. This one doesn't have, I think, assertions
22 of fact. And if they are assertions of fact, we are not
23 offering them for their truth.

24 There are other chats where there are some assertions
25 of fact that I think are also admissible for their truth based

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1 on the state of mind assertion.

2 But this was -- 1013E is one where I don't think I
3 heard one way or the other from the government if they have an
4 objection or didn't have an objection, so I am just not sure.

5 MS. ESTES: Your Honor, we don't object to 1013E.

6 MR. WEDDLE: OK.

7 THE COURT: OK.

8 MR. WEDDLE: So 1013G I also am not sure if the
9 government objects.

10 MS. ESTES: We don't object to this one either.

11 THE COURT: All right.

12 MR. WEDDLE: 1013I the government does object, I
13 understand, is that right?

14 MS. ESTES: Your Honor, we don't object to this if it
15 is not offered for its truth.

16 MR. WEDDLE: We had are not offering it for its truth.

17 THE COURT: OK. That is I?

18 MR. WEDDLE: Yes.

19 THE COURT: All right.

20 MR. WEDDLE: 1013J I think is admissible not for its
21 truth. I believe the government does object to 1013J to the
22 extent it is offered for its truth.

23 MS. ESTES: That is correct, your Honor.

24 THE COURT: But you don't object insofar as it is
25 offered for I guess state of mind?

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1 MS. ESTES: Your Honor, I am not sure how that is
2 exactly relevant since these aren't -- some of these texts
3 aren't with Jeff Wada, they are with Cindy Holder and Brian
4 Sweet. I mean, I suppose the Jeff Wada ones could arguably be
5 admissible for state of mind, but I don't know how the Brian
6 Sweet and Cindy Holder ones are relevant to Wada's state of
7 mind.

8 MR. WEDDLE: We're definitely not offering Brian Sweet
9 or Cindy Holder texts for their truth. This is mostly to show
10 the context and the back and forth that kind of -- in some of
11 the same moments when Cindy Holder is texting with Jeff Wada,
12 and that particular conversation has a certain character to it,
13 she is also texting with Brian Sweet. And I think that the
14 manner in which those two things are juxtaposed, your Honor,
15 well, I think is relevant to show whether or not it appears
16 that they are all part of a single conspiracy or if they are
17 doing different things and they are different independent
18 conversations.

19 THE COURT: And on this one, there is no government
20 exhibit -- there were other emails on the same -- other texts
21 on the same day?

22 MR. WEDDLE: There is no corresponding government
23 exhibit for this date.

24 THE COURT: So what is its relevance exactly?

25 MR. WEDDLE: Well, I mean, it is showing the character

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1 of the conversation between Jeff Wada and Cindy Holder. She is
2 conversing with him basically about how is -- what's happening
3 with his promotion, ostensibly, at the same time she is
4 conversing with Brian Sweet about who actually got promoted.
5 Right? So they're sharing information back and forth about
6 what is happening to who and how they feel about it at the
7 PCAOB.

8 And then Cindy Holder asks Jeff Wada for the list of
9 who has been promoted. And then, you know, she is reporting
10 back to Brian Sweet about her request to Jeff Wada to email a
11 list of who was promoted.

12 THE COURT: OK. I guess for a nonhearsay purpose it
13 is all right.

14 MR. WEDDLE: And 1013K, I believe the government also
15 objects to this on hearsay grounds.

16 Again, your Honor, we are offering this not for its
17 truth -- or it is relevant not for its truth but also to show
18 the state of mind of Mr. Wada. I think the government's
19 allegation is that Mr. Wada was violating the rules as part of
20 a criminal conspiracy and what he hoped to get out of it was a
21 job. This series of discussions has to do with other people and
22 Mr. Wada proposing other people as recruitment targets for KPMG
23 in the context where we've heard evidence that Cindy Holder
24 could get a pretty substantial bonus for recruiting people. So
25 it is a different purpose. It is inconsistent with the

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1 government's allegation for this conversation, and it sheds
2 light upon the character of their relationship that the
3 government has contended is a criminal conspiracy that includes
4 Brian Sweet and others.

5 THE COURT: And this is all between Wada and Holder?

6 MR. WEDDLE: Yes. Most of these are questions, your
7 Honor. So there is not a hearsay objection to a question, of
8 course. But the ones that are statements I think are
9 admissible not for their truth but to show the things that I
10 just said before.

11 THE COURT: Yeah. I think they probably would be
12 admissible for their truth. I'm just not exactly sure how they
13 are relevant. I mean, they -- I guess they could go to -- you
14 are saying they go to the general character of the
15 communications?

16 MR. WEDDLE: Yes, and it is inconsistent. If the
17 government's theory is Mr. Wada wants a job so badly that he
18 will engage in a criminal conspiracy, it is inconsistent with
19 that to be proposing other candidates for recruitment by KPMG.

20 MS. ESTES: Your Honor, we object to this being
21 offered for their truth. I think it is a stretch that they are
22 relevant, but -- you know, it is fine, we are not going to
23 object to them coming in at all.

24 THE COURT: OK. So I'll let K in.

25 Are there others --

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1 MR. WEDDLE: L is also objected to on hearsay grounds.
2 The back and forth with Mr. Sweet has to do with, you know,
3 sort of gossip about PCAOB personnel, including Joe Miller, who
4 other texts will show Cindy Holder corresponded with. He was a
5 current PCAOB employee at the time. There is a reference to
6 Bob, which I think is Bob Ross. We've heard testimony about
7 that also.

8 And then there is a little bit of back and forth
9 between Mr. Wada and Ms. Holder. The part that is relevant is
10 where Mr. Wada is saying I wanted to check in about Kristy
11 Zang. That's all. So, here again, he's checking in with
12 Ms. Holder not about providing information or getting himself a
13 job at KPMG but in proposing another coworker for a job at
14 KPMG.

15 (Continued on next page)
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1 THE COURT: Does the government object?

2 MS. ESTES: Your Honor, I'm not sure of the relevance
3 of the Brian Sweet text at the top, we don't object to the Wada
4 ones at the bottom.

5 THE COURT: Yes. I'm having a hard time seeing how
6 the Sweet/Holder communications, especially when they're not
7 even on the same day as the bottom two, could come in but I
8 will let the bottom two in. How about that?

9 MR. WEDDLE: 1013M is primarily a repeat of
10 Government's Exhibits. All we have added are two back and
11 forths with Joe Miller and obviously this is an important day
12 in the case, your Honor, and I think that it's relevant that
13 Cindy Holder is reaching out to Joe Miller in the midst of that
14 day who is a current PCAOB employee.

15 MS. ESTES: Your Honor, I'm not sure how a text saying
16 "Happy Easter" is really relevant to the events of that day.
17 We obviously don't object to the ones that are already in
18 evidence as Government Exhibit 1442 and 1443.

19 THE COURT: I don't see how the text saying "Happy
20 Easter" is relevant to anything.

21 MR. WEDDLE: Your Honor, I think there is lots of
22 testimony about the fact that Brian Sweet thought it was part
23 of his job to maintain relationships with PCAOB personnel.
24 Mr. Whittle testified that in his experience, when people are
25 in contact with PCAOB personnel information flows, was the

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1 testimony that he gave. I think the evidence before the Court
2 has shown that Cynthia Holder seems to have taken her lead
3 before Brian Sweet in terms of finding it to be part of her job
4 to cultivate sources of information and to use those sources of
5 information for her own purposes and the fact that on March
6 28th, the day that the government contends an inspection list
7 was obtained by KPMG, she has decided to reach out to Joe
8 Miller is relevant, your Honor.

9 THE COURT: Okay. I will allow it.

10 Next one is O.

11 MR. WEDDLE: Yes, we are not going to offer O.

12 THE COURT: All right. P?

13 MR. WEDDLE: P. This is a text back and forth between
14 Brian Sweet and Cindy Holder and I think this sheds light on
15 Brian Sweet's state of mind for some of the same reasons I was
16 just discussing, your Honor.

17 Both Brian Sweet and Cindy Holder appear to have
18 thought it was part of their job to cultivate sources of
19 information and so this -- I think the fact that Brian Sweet
20 says "I saw Bob last night, got him drunk and heard some
21 interesting things about D firm," is relevant to Mr. Sweet's
22 relationships with PCAOB personnel including Bob Ross who we
23 have heard about.

24 MS. ESTES: Your Honor, I think they're only offering
25 this "I saw Bob last night and got him drunk" text for the

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1 truth of what it says -- that Sweet saw Bob Ross and got him
2 drunk. They certainly could have asked Mr. Sweet about this in
3 his testimony. Instead, they didn't do that and now they want
4 to offer a text that is hearsay. This doesn't go to his state
5 of mind. They're trying to offer it for the truth so I don't
6 see how it is admissible.

7 MR. WEDDLE: There is a distinction, your Honor, and
8 maybe a fine distinction, but I don't actually care whether Bob
9 Ross was drunk or how well he holds his liquor. What we are
10 offering this for is to show Brian Sweet's intent in his
11 ostensible -- his meeting with Bob Ross which may have
12 ostensibly had other purposes. His intent as part of that
13 meeting was to get him drunk and find out other information.

14 MS. ESTES: Your Honor, I think it only shows his
15 intent if you accept the truth of "I saw Bob Ross." So, that's
16 the problem.

17 THE COURT: I think that is hearsay.

18 R?

19 MR. WEDDLE: R. The first couple of pages are all
20 government exhibits.

21 THE COURT: And you are adding?

22 MR. WEDDLE: We are adding some additional context.

23 THE COURT: Any objection to this?

24 MS. ESTES: Yes, your Honor.

25 The last couple pages are hearsay and also just should

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1 be precluded under 403. Mr. Wada, for instance, texted Cindy
2 Holder about the death of his mom, a medical problem that his
3 brother had about the death of his grandfather and about his
4 own heart condition. And, his dad flatlined.

5 All of these medical issues of his family, there is no
6 relevance here and they're incredibly prejudicial and they're
7 really asking the jury to find him sympathetic. So, we think
8 all of these should be precluded.

9 MR. WEDDLE: Well, your Honor, we will withdraw the
10 last page and the two lines that Ms. Estes just talked about
11 which is the 9:47 and 9:48 texts about his dad.

12 I think there are statements by Mr. Wada that are
13 admissible under 803.3. For example, on the page prior to
14 that, so the number in the lower left of the page says
15 DX 1013R-3, here there is a conversation that's going on
16 between Jeffrey Wada and Cynthia Holder about Jung Lee, who is
17 another PCAOB employee that we have heard testimony about, and
18 Jeffrey Wada says "I need to check out my heart murmur first."
19 That's a statement about his state of mind, that's admissible
20 under 803.3, and it shows what is forefront in his mind at that
21 time period when Cynthia Holder is trying to talk to him about
22 some other things including Jung Lee and what is going on with
23 Jung Lee's employment. He is worried about and expressing that
24 in a manner that is clearly within an exception to the hearsay
25 rule. He is talking about what he needs to do and then he

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1 makes a number of statements about what he plans to do which
2 are also admissible under 803.3 based on his statement of
3 intent and he is talking about, you know, his health condition.

4 MS. ESTES: Your Honor, we don't have an objection to,
5 for instance, the 9:47 a.m. text, "if I have a heart murmur and
6 it is all stress related I can't go back to the Big Four." And
7 I guess whatever couple of surrounding tests may be needed to
8 add context to that.

9 On page 3 there is a 9:42 a.m. text they have here
10 standing alone without the text that precedes it. The text
11 that precedes it, I believe, is a text where Wada says
12 something about Mr. Jung Lee is going to have to get hired by
13 Mr. Trump. But it frames actually this following text so I
14 don't think the 9:42 a.m. text is relevant or admissible
15 without the text in front of it which explains, like, why Cindy
16 Holder replies that to Jeffrey Wada.

17 MR. WEDDLE: We will withdraw that one, your Honor.

18 THE COURT: Okay. You are withdrawing that one. What
19 about starting with the bottom of that page?

20 MR. WEDDLE: I think those are admissible.

21 MS. ESTES: Your Honor, I think on this maybe it makes
22 sense, since it sounds like they are withdrawing something and
23 we are agreeing, for us to consult and once we have a new
24 exhibit to see if there are any issues.

25 MR. WEDDLE: That's fine.

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1 THE COURT: Okay.

2 MR. WEDDLE: S, like Sam, it is mostly a government
3 exhibit and it is mostly to show the interspersed, what you
4 might say are back-channel communications that are taking place
5 in the midst of this conversation between Cynthia Holder and
6 Jeffrey Wada are her back-channel communications with Brian
7 Sweet.

8 MS. ESTES: Your Honor, this one is fine with us.

9 THE COURT: All right.

10 MR. WEDDLE: T, we are not offering for its truth.

11 MS. ESTES: Your Honor, I don't think we understand
12 the relevance of it, if not for its truth.

13 MR. WEDDLE: It is basically saying that Brian Sweet
14 heard information about whether Wells Fargo was going to be
15 inspected from a different source.

16 MS. ESTES: Right, your Honor.

17 I think that, again, is the part that is hearsay that
18 Brian Sweet says Dave just called me because he got a call from
19 Torrente about Wells not getting picked. To accept the
20 argument you have to accept that is true.

21 Again, this is something they could have asked Brian
22 Sweet about in his testimony. They chose not do it. I don't
23 think they should be able to back door this in through a text
24 message that is clearly hearsay.

25 THE COURT: I think it is hearsay.

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1 MR. WEDDLE: It is just relevant for the fact that he
2 is saying it, your Honor. I mean he is saying it, that Wells
3 is not going to be picked, to Cynthia Holder, it is relevant to
4 both of their states of mind and it sheds light on the
5 confidentiality of the information that supposedly they learned
6 days later.

7 THE COURT: But it's all based on the truth of the
8 fact that he got a call from Torrente about Wells not getting
9 picked.

10 MR. WEDDLE: I think it is also relevant for the
11 effect on the listener Cynthia Holder. Whether or not he got a
12 call she was told that he got a call and that's old news and he
13 is getting confidential information from other sources. Or
14 information from other sources. I don't know if it is
15 confidential or not confidential, in the government's view.

16 MS. ESTES: Your Honor, I think it is just hard to
17 even articulate. What are they going to actually argue about
18 Cynthia Holder's state of mind based on this? They clearly
19 want to argue that Sweet got a call saying Wells is not getting
20 picked on January 6. That's what they want to argue? I don't
21 think they've articulated any relevance that is not basic
22 hearsay.

23 THE COURT: I think I agree. I don't see any
24 non-hearsay purpose.

25 Letter U.

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1 MS. ESTES: This is fine, your Honor.

2 THE COURT: And V?

3 MR. WEDDLE: V, I think, is the beginning of the
4 conversation, your Honor, and the government exhibit kind of
5 starts midstream, "I'm talking about edits to my résumé." It
6 is something proposed by Cindy Holder coming from Brian Sweet.

7 MS. ESTES: Your Honor, we offered most of the first
8 message. The only part we redacted the part after this "week
9 or early next week" where it says, "Hope are you doing okay.
10 Sending prayers for you, Marian and the kids. You got this."
11 We redacted all of that part. And, "for the record, I won't
12 officially stalk until 2/8," because it seemed irrelevant. It
13 seems like it is, again, another plea for sympathy and just an
14 unnecessary reference to his wife and kids. It has no
15 relevance.

16 MR. WEDDLE: Your Honor, it is not a plea for
17 sympathy. I think that it shows that one of the things that
18 they were talking about, in fact I would submit one of the most
19 important things they were talking about in the time frame were
20 the health issues that Mr. Wada was going through and this is
21 whatever this is, this is less than two weeks from when he has
22 heart surgery. So, it is an evolving situation and they're in
23 contact about his health. There is going to be a stipulation
24 about the series of health-related tests and appointments that
25 he had in this time frame and I think it sheds light on the

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1 content of their conversations.

2 THE COURT: I don't think it sheds light in any
3 relevant way.

4 Is that it?

5 MR. WEDDLE: We have a couple more that are not
6 excerpted from there. I don't want to spring this on Ms. Estes
7 but we have 1648, which is chats from Ms. Holder and Jung Lee.

8 MS. ESTES: What is this? The May and June ones?

9 MR. WEDDLE: May and June, yes.

10 MS. ESTES: Your Honor, those are fine if they're not
11 offered for the truth.

12 THE COURT: All right.

13 MR. WEDDLE: And I think we have -- well, why don't we
14 take this up separately. We have two from Brian Sweet's phone
15 but I don't think we discussed them.

16 That's all I think we have for those. Hopefully the
17 other two are not an issue.

18 THE COURT: Okay.

19 MR. WEDDLE: Thank you, your Honor.

20 THE COURT: All right. And anything else anybody
21 wanted to talk about this evening?

22 MR. BOXER: Not from us your Honor.

23 MS. MERMELSTEIN: Nothing further, your Honor.

24 THE COURT: Okay. Have a good night, everybody.

25 (Adjourned to March 5, 2019 at 9:30 a.m.)

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DEFENDANT EXHIBITS

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M132531

M1302537

M1292539

M-3142569

M2112579

1	M3052590
2	M-2772649
3	M1862663
4	M3062740
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